Ireland – Stability Programme Update

December 2007

Foreword

This document updates Ireland's Stability Programme. It includes macroeconomic projections up to 2010 and takes account of the measures adopted in Budget 2008.

This Update takes account of Budget 2008 and is being presented to Dáil Éireann and submitted to the European Commission on Budget Day, 5 December 2007. As such, it also provides an update of the economic background to Budget 2008. The previous update and the related Council Opinion were presented and discussed at the Dáil Select Committee on Finance and the Public Service on 22 March 2007.

The document has been prepared in accordance with Council Regulation (EC) No. 1055/2005 amending regulation 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 September 2005.

The Stability Programme should be seen in conjunction with the October 2007 implementation report on Ireland's National Reform Programme (NRP) which outlines a broad range of policies and initiatives to sustain Ireland's strong economic growth and employment performance in the context of the Lisbon Strategy for Growth and Jobs.

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[1] Indicators in bold in the tables are a requirement of the guidelines for the format and content of Stability and Convergence Programmes.

Chapter 1 - Overall Policy Framework and Objectives

The Government's guiding economic and budgetary principles are to achieve further significant, sustainable growth while operating responsible fiscal policy. Government policy seeks to build for the future by raising Ireland's productive capacity, particularly in terms of public infrastructure and ensuring high-levels of high-quality employment, and in doing so to improve quality of life and achieve a more equitable society. Delivery of the medium-term economic policy and investment framework as set out in the National Development Plan 2007 – 2013 is the key priority for the Government to raise Ireland's productivity, enhance our competitiveness and secure our future prosperity. The Government is committed to making significant progress in reaching environmental targets and is implementing a comprehensive range of measures as set out in its new National Climate Change Strategy and initiating a carbon report with this Budget.

The Government's guiding principles for fiscal policy for 2007 – 2012 as set out in their Programme for Government are to:

- Keep the Budget in broad balance and fully within the commitments under the Stability and Growth Pact.
- Retain flexibility to deal with any future shocks
- Set aside a minimum of 1% of GNP per annum to provide for the future pensions of today's workers.
- Implement a series of significant and sustainable increases in key public services such as pensions, health and schools.
- Keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system.

The Government is committed to the Stability and Growth Pact as the framework for medium-term budgetary policy. In the context of relatively more modest growth prospects over the programme period and while maintaining high levels of public investment, it is envisaged that ongoing compliance with the Pact will be supported by more moderate levels of increase in current expenditure.

1.1 Economic Outlook

The prospects are for a moderation in the growth rate of the Irish economy, partly reflecting lower levels of new housing output in the short-term. An average GDP growth rate of 3.5% per annum over the period 2008 – 2010 is currently projected. Employment growth is expected to slow, and a modest increase in unemployment appears to be in prospect. These developments should contribute towards an easing in price pressures, and the harmonised inflation rate is forecast to average about 2.1% per annum over the forecast horizon.

This relatively benign scenario is contingent upon a continuation of reasonably solid growth in the global economy, and in our major trading partners in particular. A deterioration in the external environment would have adverse implications for developments in the Irish economy. In this context, the downside risks to the international economy have clearly intensified in recent months.

1.2 Budgetary Stance

The projected budgetary position over the period 2008 – 2010 is for a General Government budget deficit of -0.9% of GDP in 2008 followed by deficits of -1.1% in 2009 and -1.0% in 2010. In terms of the cyclically-adjusted budget balance (CABB) a small deficit of -0.3% of GDP is projected in 2008. The cyclically adjusted position points to deficits of -0.4% in 2009 and -0.6% in 2010. However, if the contingency provision is excluded the cyclically adjusted position shows a balanced position in

2009 and a modest surplus in 2010. The programme respects the terms of the Stability and Growth Pact, and is consistent with a medium-term objective of keeping the budget close to balance. It is therefore compliant with the medium-term objective as outlined in Council regulation 1055/2005 amending regulation 1466/1997.

The debt-to-GDP ratio will be maintained at one of the lowest in the euro area, averaging around 27.4% over the forecast period. The market value of the assets of the National Pensions Reserve Fund was in the region of 11% of GDP at the end of September 2007.

Table 1 – General Government Balance and Prospective Debt Ratio

% of GDP	2007	2008	2009	2010
General Government Balance	0.5	-0.9	-1.1	-1.0
Cyclically-Adjusted Balance	0.7	-0.3	-0.4	-0.6
Debt Ratio (year end)[2] [3]	25.1	25.9	27.6	28.7

Source: Department of Finance

[2] The General Government debt ratio is measured on a gross basis, so liquidity held at year end will affect the gross debt.
[3] The GG debt ratio does not take into account the funds in the National Pensions Reserve Fund which at end September 2007 was equivalent to 11 % of GDP.

Chapter 2 – Economic Outlook 2007 – 2010

2.1 Summary

Based on the latest information to hand it now seems that the very strong growth experienced in the first half of 2007 has eased as the year progressed, mainly on foot of lower levels of new housing output. A further decline in new housing output is expected next year and this, together with other factors, is expected to weigh on growth. In these circumstances, the outlook is for a moderation in the rate of economic expansion in Ireland next year, with GDP growth likely to be of the order 3 per cent. However, a modest pick-up in the growth rate is projected for the later years of the forecast period as housing output stabilises. This outlook, which is based on available data up to end-November 2007 and the European Commission's assumptions regarding key external variables,[4] assumes a re-balancing of growth towards external demand. This, in turn, assumes continued growth in our main foreign markets and no further deterioration in our competitive position. At this stage, prospective developments in the global economy are even more uncertain than normal, with risks clearly skewed to the downside. If any of these risks were to materialise, Ireland with its strong ties to the global economy would not be immune from the fallout.

Table 2 – Summary of Economic and Budgetary Indicators: 2002 – 2007

% volume change unless otherwise indicated	2002	2003	2004	2005	2006	2007
GNP	2.9	5.7	3.7	4.9	6.5	4.2
GDP	6.4	4.3	4.3	5.9	5.7	4.8
Private consumption	4.2	3.0	4.1	7.3	5.7	6.6
Government consumption	7.0	1.2	1.5	4.0	5.3	4.8
Gross domestic fixed capital formation	3.3	5.5	6.9	11.8	3.1	1.5
Exports of goods and services	5.2	0.6	7.3	5.2	4.4	6.8
Imports of goods and services	2.6	-1.6	8.5	7.7	4.4	5.9
BoP Current account (% GDP)	-1.0	-0.0	-0.6	-3.5	-4.2	-4.4
Harmonised Index of Consumer Prices	4.7	4.0	2.3	2.2	2.7	2.8
Consumer Price Index (% change)	4.6	3.5	2.2	2.5	4.0	4.9
Unemployment (% of labour force)	4.4	4.6	4.4	4.3	4.4	4.6
Employment (% change)	1.8	1.9	3.0	4.7	4.4	3.5
Employment change ('000)	32	34	54	87	87	72
General Gov. Balance (% GDP) *	-0.4	0.4	1.3	1.2	2.9	0.5
General Gov. Debt (% GDP)	32.2	31.1	29.5	27.4	25.1	25.1

* Deficit (-) / Surplus (+).
Source: 2002 – 2006 CSO, except for public finance figures which are produced by the Department of Finance.
2007 Department of Finance estimates.

2.2 The Economy in 2007

The economy appears set to record a fairly solid performance this year, with GDP growth likely to be around 4.8%. The rate of GNP growth is expected to be slightly lower at 4.2% reflecting the higher profit outflows generated from a reasonably good exporting performance in the foreign-owned sector. However, the outlook for residential investment has softened as this year has progressed, although other investment activity, including NDP spending, has performed well. Employment is expected to expand by 3.5%, with the unemployment rate remaining low at around 4.6%. The Harmonised Index

[4] The European Commission's assumptions regarding key external variables are set out in annex 1.

of Consumer Prices (HICP) measure of inflation is expected to average 2.8% for the year as a whole, around 0.8 percentage points higher than that in the euro area.

External Developments
The global economy is experiencing strong levels of growth despite the ongoing developments in the world's financial markets and rising oil prices during the year. World GDP is forecast to grow by more than 5% this year.

Forecasts for our main trading partners are presented in table 4. Growth in the United States is forecast to ease this year, mainly reflecting housing market developments. Growth in Japan slowed in the second quarter of 2007, reflecting slower global growth. Growth in the rest of Asia remains strong. The euro area has continued to expand at a reasonable rate while further strong GDP growth in the UK is expected.

Domestic Demand
Consumer demand was relatively buoyant this year, supported by strong employment and earnings growth as well as the maturing of the SSIA scheme for many account holders. National accounts data show that the volume of consumer spending in the first half of the year was 5.8% higher than in the same period a year earlier, while retail sales data for the third quarter point to a broad continuation of this trend. For the year as a whole, personal consumption is expected to increase by 6.6%.

The volume of government consumption rose by 6.2% year-on-year in the first half of this year, and an increase of 4.8% is expected for the year as a whole is expected.

In terms of the components of demand, perhaps the most significant development over the past year has been in residential investment spending, which on an annual basis, declined in the second and third quarters of 2007. Leading indicators of future output – such as new house registrations and commencements – have softened as the year has progressed. As a result, a further easing of output is expected in the fourth quarter of this year and into next year. In these circumstances, the level of new housing output is now expected to be in the mid-to-low 70,000's for this year.

Spending on other components of building and construction – such as home improvements, commercial property and the ongoing roll out of the National Development Plan – has remained strong, while purchases of machinery and equipment have been fairly robust in the year to date, partly reflecting aircraft purchases. As a result, national accounts data show that investment spending in the first half of the year was 9.6% higher than in the same period of last year. Nevertheless, given prospective developments in the second half of the year in the house building sector, the rate of increase for the year as a whole is expected to be just 1.5%.

Exports
Available data point to a recovery in the exporting performance this year. For instance, quarterly national accounts data show that the volume of exports in the first half of the year was 7.7% higher than in the same period of last year. This was composed of a 5.5% increase in merchandise exports and an 11% increase in exports of services. While data limitations prevent a more definitive assessment, it appears likely that the chemicals and ICT sectors were the driving forces behind the expansion of merchandise exports, while computer and business services were the main contributors to services export growth. Data relating to industrial production – the bulk of which is exported – suggest further solid export growth in the third quarter. Taking into account these developments together with trends in our principle foreign markets and in competitiveness, exports are expected to rise by 6.8% this year.

Final Demand and Imports
Imports of goods and services in the first half of the year were 5.6% higher than in the same period a year earlier. Merchandise imports were 7.2% higher over this period; the equivalent rate of increase for services imports was 4.2%. For the year as a whole, final demand is expected to rise by 5.5% in volume terms, with imports likely to expand by around 5.9%.

Balance of Payments

The current account of the balance of payments is expected to record a deficit of 4.4% of GDP this year. This would be the largest deficit since the current methodology for compiling these statistics was introduced in 1998. The deterioration in the current account position in recent years reflects a number of factors. The merchandise trade surplus has declined due to a general deterioration in competitiveness, robust domestic demand growth and adverse movements in the terms of trade. Developments on the merchandise trade side have only been partially offset by the improvement in the services deficit, while the negative balance between income outflows and inflows has widened.

Employment and Earnings

The labour market remained strong in the first three quarters of the year. Total employment rose by 67,600 (3.3%) year-on-year in the third quarter of 2007, with the financial and other business services, hotel and restaurant and education sectors recording the strongest growth rates.

The labour force expanded at an annual rate of 3.2% (68,900) in the third quarter, with strong net inward migration and increased participation continuing to be the main driving forces behind the increase. Non-Irish nationals now account for nearly 12% of the labour force. The unemployment rate averaged 4.5% in the first three quarters of the year, marginally higher than in the same period of last year. The latest Live Register data, which relate to October, show a standardised rate of unemployment of 4.8%.

Available data point to strong earnings growth in the first half of the year. Hourly earnings in the construction sector rose by 6.1% year-on-year in the second quarter, while weekly earnings in the financial sector were 6.9% higher. Industrial hourly earnings rose by 5.0% and average weekly earnings in the business and distribution sectors were up by 5.2% for the same period. In the public sector excluding health, average weekly earnings increased by 5.5% year-on-year. In terms of the year as a whole, earnings per capita in the non-agricultural sector are forecast to rise by around 5% this year.

Gross Domestic Product and Gross National Product

Quarterly national accounts data show that GDP rose by 6.7% year-on-year in the first half of this year, with GNP rising by 5.7% over the same period. A slowdown in the rate of expansion is expected in the second half of the year, mainly reflecting the impact of lower residential construction output. For the year as a whole, GDP and GNP are now expected to rise by 4.8% and 4.2% respectively. The moderately higher growth rate for GDP relative to GNP reflects the composition of growth which is more export-led than assumed in last year's Update.

Inflation

The Harmonised Index of Consumer Prices (HICP) measure of inflation averaged 2.8% in the first ten months of the year, 0.8% higher than the euro area equivalent over the period, mainly reflecting higher services sector inflation in Ireland. For the year as a whole, HICP inflation is expected to average 2.8% in 2007.

Table 3 sets out the Budget 2007 macroeconomic forecasts as published on 6 December 2006 together with the latest estimates for economic developments for 2007.

Table 3 – Economic Indicators 2007: Budget Forecast and Estimated Outturn

	2007 Forecast (December 2006)	2007 Estimate (December 2007)
GNP (% volume change)	5.3	4.2
GDP (% volume change)	5.3	4.8
Consumer prices - HICP (% change)	2.6	2.8
Consumer prices - CPI (% change)*	4.1	4.9
Unemployment rate (% labour force)	4.4	4.6
Employment growth ('000)	72	72
Employment growth (%)	3.5	3.5

Source: Department of Finance.
* The higher rate of CPI inflation relative to HICP inflation reflects the impact of higher mortgage interest repayments which, in turn, reflects increases in wholesale interest rates.

2.3 Macroeconomic Projections 2008 – 2010[5]

Overview

Short-term prospects for the international economy appear to be more uncertain than usual, reflecting a number of recent developments, including financial market developments, rising oil prices and the appreciation of the euro against both the dollar and sterling. While the outlook is for reasonably solid – albeit slowing – growth in many of our key trading partners, there is considerable downside risk attached to this scenario.

Domestically, the projected further easing in new residential construction will curb growth in 2008. As this is relatively labour-intensive activity, employment growth is forecast to slow, which in turn is assumed to affect the evolution of private consumption. As a result, the growth rate of domestic demand is forecast to slow next year, and to broadly stabilise thereafter. In overall terms, GDP is forecast to expand by 3% next year, before re-accelerating as the drag from lower residential output fades.

However, there are a number of key identifiable downside risks that stem from both potential external and internal developments. In particular:

- further adverse exchange rate movements are possible;
- notwithstanding the current elevated level of oil prices, further increases cannot be ruled out;
- given the importance of the US as a trading partner and as a source of investment, a deeper or more prolonged downturn in that economy could have a disproportionate impact on Irish economic prospects;
- financial market uncertainty could potentially persist for some time, while spill-over effects to the real economy could become more pronounced than is currently assumed;
- the decline in new residential investment could be steeper or more prolonged than assumed.

[5] The forecasts contained herein are not directly comparable with those published in the Pre-Budget Outlook published on 18 October 2007 (see box 1 for an explanation of the differences).

The main upside risk to the outlook relates to the possibility that the external sector records stronger than assumed growth.

Box 1: Revisions compared to Pre-Budget Outlook[6]

The Department of Finance published its *Pre-Budget Outlook* (PBO) in mid-October. The PBO, which contained macro-economic and budgetary projections covering the period 2007 – 2010, was expanded this year to show full detailed pre-Budget Estimates of Expenditure for the year ahead. The pre-Budget Estimates show the estimated cost of maintaining the existing level of public services in the year ahead[7], and in this way facilitate transparency regarding the actual resource allocation decisions made in the Budget. In addition, an unallocated capital provision was included, to allow for the planned increase in the multi-annual capital envelopes under the National Development Plan.

The macro-economic and budgetary forecasts included in this *Stability Programme Update* (SPU) differ from those in the PBO for a number of reasons. Firstly, policy decisions regarding spending and taxation announced in the Budget will affect the economy as well as the public finances. Secondly, the PBO projections were based on data and other information available up to end-September, while those in the SPU are based on published data up to end-November.

External Outlook

For the purposes of these forecasts, the international economy is assumed to evolve in line with the forecasts of the EU Commission in the Autumn Forecasts.[8] The European Commission's Autumn economic forecasts predict that EU growth will be just under 3% this year. Forecasts for GDP growth in both the euro area and the EU27 have eased as this year has progressed reflecting the less benign external environment. In the UK, growth is expected to moderate slightly from 3.1% in 2007 to 2.2% in 2008, before rising again to 2.5% in 2009. Growth is forecast to slow in the United States from 2.1% in 2007, to 1.7% in 2008 and 2.6% in 2009. This reflects the impact of the financial market difficulties, the drag of the housing market and slowing private consumption growth. On the external side, risks which could affect the economic outlook include deepening financial market strains, volatile oil markets, increasing food prices and the strength of the US dollar.

Demand in Ireland's export markets is expected to rise by 5.4% next year, a slower rate of increase than that recorded this year, partly reflecting more modest growth in the US. An acceleration to 5.7% is forecast for the following year.

Below, in table 4, are the forecasts for GDP growth in Ireland's main trading partners.

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

	2006	2007	2008	2009
Euro area	2.8	2.6	2.2	2.1
Germany	2.9	2.5	2.1	2.2
France	2.0	1.9	2.0	1.8
Italy	1.9	1.9	1.4	1.6
UK	2.8	3.1	2.2	2.5
EU27	3.0	2.9	2.4	2.4
US	2.9	2.1	1.7	2.6
Japan	2.2	1.9	1.9	2.3

Source: European Commission Autumn Economic Forecasts, November 2007

[6] The full Pre-Budget Outlook, October 2007, is available at www.finance.gov.ie

[7] **Existing level of service** projections in the Pre Budget Outlook reflect as far as possible the cost in year t+1 of providing the actual level of service on the ground in year t. These projections apply pay and non-pay inflation, as appropriate, to the cost of services currently in place. They also provide for increases caused by known demographic demands or known extra demand in demand-led services and the full year cost of services introduced in year t.

[8] EU Commission Autumn Forecast November 2007.

Domestic Demand

The growth rate of personal consumption is forecast to moderate next year. A number of factors underpin this assessment. Firstly, the prospect of slower employment growth on foot of lower new housing output will result in more modest income growth. Secondly, the temporary impact of maturing SSIAs on consumption will, for the most part, have passed by next year. Finally, consumer confidence remains relatively low, which appears to reflect interest rates changes earlier in 2007 and some uncertainty regarding the short-term economic outlook. In overall terms, therefore, consumer spending is forecast to rise by 3.8% next year, with growth rates of a similar magnitude likely in the following years.

Public consumption is projected to rise by 3.6% in real terms next year, with growth rates of 2.9% and 2.8% in 2009 and 2010 respectively.

Fundamental factors such as the age structure of the population and the relatively low housing stock mean that the medium-term sustainable level of new residential output is estimated to be in the region of 60,000 to 70,000 units per annum. Output has been in excess of this in recent years, as supply and demand has moved closer into balance. However, available data suggest that output levels next year will be below medium term sustainable levels, with completions forecast to be around mid-50,000 units. This will have a significant impact on overall investment and on economic activity. Spending on other components of building and construction, which includes the significant additional NDP spend, is expected to remain reasonably healthy. Nevertheless, a decline in overall construction investment is expected next year. Machinery and equipment spending is very volatile and difficult to predict with any degree of accuracy, at least on a short-term basis. On the assumption of a small positive growth rate for this component, overall investment spending is forecast to decline by 1.6% next year. Thereafter, overall investment growth is expected to pick up, as housing output returns to more sustainable levels.

Exports

Merchandise exports are forecast to rise by around 4% next year. This is below the projected growth in demand in our major trading partners, and reflects the deterioration in competitiveness in recent years. A somewhat stronger growth rate for services exports is assumed, in line with the trend of recent years. As a result, overall exports of goods and services are forecast to expand by 5.6% next year. A modest easing in the rate of export growth to 5.2% and 5.0% is assumed in the later years of the forecast. In addition, the pattern of services sector exports exceeding that of merchandise exports is expected to continue. This together with the fact that the rate of increase in the price of services exports has generally exceeded that for goods (and this is expected to continue) will result in services exports accounting for an increasing share of overall exports over the forecast horizon.

Final Demand and Imports

Imports of goods and services are forecast to rise by 4.5% next year and an average annual growth rate of 4.3% over the period to 2010 is projected, broadly in line with growth in final demand over this period. Some improvement in the current account of the balance of payments is expected, reflecting the re-balancing of growth away from domestic demand and more towards external demand. A deficit of 3.9% of GDP is expected for next year.

Employment and Earnings

Reflecting prospective developments in the economy and in particular the likelihood of lower output in the labour-intensive new housing sector, the outlook is for a slowdown in the rate of employment growth next year. An increase of 1.1% is forecast for 2008, with a modest pick-up in the rate of growth assumed in the following years. As a result, the unemployment rate is assumed to rise somewhat, averaging around 5½% of the labour force over the forecast period. The actual rise in unemployment will depend on a number of factors, including the response of migrants to the somewhat less favourable employment market. Lower employment growth can reasonably be expected to result in a moderation in wage pressures which are projected to ease over the period. In addition, with the re-balancing of growth away from new residential construction and more towards the external sector, an improvement in the productivity of labour is projected.

Gross Domestic Product and Gross National Product

In overall terms, therefore, GDP is expected to increase by 3% next year, before picking up thereafter. Reflecting the composition of growth – which is expected to be more oriented towards external demand than has been the case in recent years – GNP growth is assumed to be slightly lower over the period.

Inflation

Inflation is expected to moderate over the course of 2008, partly due to the impact of higher oil prices falling out of the annual comparison, but also due to an easing in services sector inflation reflecting developments in the wider economy. In these circumstances, HICP inflation next year is forecast to be 2.4%, and to average around 2.1% for the period 2008 – 2010.

Table 5 – Macroeconomic Prospects

% change (unless otherwise indicated)	**2007**	**2008**	**2009**	**2010**
GNP growth at constant market prices	4.2	2.8	3.3	3.9
GNP at current market prices (€m)	160,350	169,000	178,850	189,975
GDP growth at constant market prices	4.8	3.0	3.5	4.1
GDP at current market prices (€m)	187,950	198,300	210,000	223,150
Components of real GDP				
Private consumption expenditure	6.6	3.8	3.9	4.0
Government consumption expenditure	4.8	3.6	2.9	2.8
Gross domestic fixed capital formation	1.5	-1.6	2.3	3.1
Exports of goods and services	6.8	5.6	5.2	5.0
Imports of goods and services	5.9	4.5	4.3	4.1
External Trade				
Current account (% GDP)	-4.4	-3.9	-3.5	-3.1
Price Developments				
HICP	2.8	2.4	2.0	1.8
Labour Market				
Unemployment (% of labour force)	4.6	5.6	5.6	5.5
Employment	3.5	1.1	1.3	1.5
Labour productivity (GDP/person employed)	1.2	1.8	2.2	2.5

Note: Tables 1a, 1b, 1c and 1d as set out in the guidelines are enclosed at annex 2 (pages 44-45).
Source: Department of Finance.

2.4 Range of Forecasts

The following table compares the Department of Finance 2008 forecasts with those of other organisations. In making comparisons, it should be borne in mind that the assumptions and timing underpinning the forecasts may be different.

Table 6 – Comparison of Macroeconomic Forecasts for Ireland in 2008

		Annual % change			
Institution	**Publication**	**GDP**	**GNP**	**HICP** (Inflation)	**Employment**
Department of Finance	*Budget 2008*	3.0	2.8	2.4	1.1
Central Bank of Ireland	*Bulletin No.4, Oct 2007*	3½	3¼	2¼	1½
ESRI	*QEC Autumn 2007*	2.7	2.9	n.a.	0.6
European Commission	*Autumn 2007 Economic Forecasts*	3.5	n.a.	2.2	1.3
IMF	*Article IV Staff Report September 2007*	3.0	2.7	2.1	1.1
Private Sector Median	*Autumn 2007*	3.4	3.2	3.2*	1.4

Source: Department of Finance and institutions cited
* Consumer Price Index

Chapter 3 – General Government Balance and Debt

3.1 Summary

The Government's budgetary strategy is based on the objective of keeping the budget in structural balance and within the commitments of the Stability and Growth Pact, while maintaining high levels of total public investment over the programme period at around 6% of GNP and well ahead of the EU average.

The outlook is for a General Government budget surplus of 0.5% of GDP in 2007, followed by deficits of -0.9% in 2008, -1.1% in 2009 and -1.0% in 2010. These projected balances include the cost of funding the National Development Plan 2007 – 2013.

The debt-to-GDP ratio is projected to be about 28.7% at end-2010, less than half the present EU average debt level of just under 60% of GDP, and among the lowest in the euro area.

3.2 Policy Strategy

The Government's guiding principles for fiscal policy for 2007 – 2012 as set out in their Programme for Government are to:

- Keep the Budget in broad balance and fully within the commitments under the Stability and Growth Pact.
- Retain flexibility to deal with any future shocks
- Set aside a minimum of 1% of GNP per annum to provide for the future pensions of today's workers.
- Implement a series of significant and sustainable increases in key public services such as pensions, health and schools.
- Keep the overall tax burden low and implement further changes to enhance the rewards of work while increasing the fairness of the tax system.

Delivery of the medium-term economic policy and investment framework as set out in the National Development Plan 2007 – 2013 is the key priority for the Government. Under the Plan, published in January 2007, the Government plans to invest an average of around 6% of GNP per annum in a programme of investments designed to underpin economic development. The Government is committed to ensuring that this investment will be delivered within the framework of economic and budgetary stability and in full compliance with the requirements of the EU Stability and Growth Pact over the Plan period.

3.3 Budget Balance

A surplus of 0.5% of GDP on the General Government Balance is currently projected in 2007.

The change in the forecast outturn GGB for 2007 compared with the Budget estimate is mainly due to a projected shortfall in tax receipts of €1,750 million or 0.9% of GDP. This is largely due to a slowdown in property related taxes.

This tax shortfall is partly offset by a reduction in National Debt interest payments, an increase in National Pensions Reserve Fund investment income, and an improvement in the net surplus of the Social Security sector. Together these improvements total some 0.2% of GDP.

A General Government deficit of -0.9% of GDP is forecast for 2008, followed by deficits of -1.1% in 2009 and -1.0% in 2010. Ireland is expected to continue to have one of the lowest debt-to-GDP ratios in the euro area, with the ratio averaging around 27.4% over the forecast period.

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 which is a technical gross measure.

More detailed information in relation to Government expenditure and revenue issues is set out in chapter 5.

Table 7 – General Government Budgetary Prospects

	2006 €m	2006 % of GDP	2007 % of GDP	2008 % of GDP	2009 % of GDP	2010 % of GDP
Net Lending by sub-sector						
1. **General government** (=2+4+5) (=8)	5,107	2.9	0.5	-0.9	-1.1	-1.0
2. **Central government**	3,993	2.3	0.2	-1.1	-1.4	-1.2
4. **Local government**	384	0.2	-0.1	-0.1	-0.1	-0.1
5. **Social security funds**	730	0.4	0.4	0.3	0.3	0.3
General government						
6. **Total Revenue** (=16)	64,845	37.1	36.6	36.1	35.8	35.4
7. **Total Expenditure** (=24)	59,738	34.2	36.1	37.0	36.9	36.5
8. **Net lending/borrowing** (=6–7) (=1)	5,107	2.9	0.5	-0.9	-1.1	-1.0
9. **Interest expenditure** (=20)	1,781	1.0	0.9	1.0	1.1	1.1
10. **Primary balance** (=8+9)	6,888	3.9	1.4	0.0	-0.1	0.0
11. One-off & temporary measures	*250*	*0.1*	*0.2*	*0.0*	*0.0*	*0.0*
Selected components of revenue						
12. Total taxes	47,977	27.5	26.7	26.2	25.9	25.7
a. Taxes on production and imports	24,607	14.1	13.6	13.4	13.3	13.1
b. Current taxes on income & wealth	23,034	13.2	12.9	12.6	12.4	12.3
c. Capital taxes[9]	336	0.2	0.2	0.2	0.2	0.2
13. Social contributions	10,924	6.3	6.4	6.4	6.4	6.4
14. Property Income[10]	1,794	1.0	1.1	1.2	1.2	1.1
15. Other	4,150	2.4	2.5	2.4	2.3	2.2
16. Total Revenue (=12 to 15) (=6)	64,845	37.1	36.6	36.1	35.8	35.4
Tax Burden[11]	*59,322*	34.0	*33.3*	*32.8*	*32.6*	*32.3*
Selected components of expenditure						
17. Compensation of Employees + **18. Intermediate Consumption**	25,678	14.7	15.3	16.1	16.2	16.1
19. Total social payments	19,163	11.0	11.7	11.7	11.6	11.5
a. Social transfers in kind	2,983	1.7	1.8	1.9	1.8	1.8
b. Social transfers other than in kind	16,180	9.3	9.9	9.9	9.8	9.7
20. Interest Expenditure (=9)	1,781	1.0	0.9	1.0	1.1	1.1
21. Subsidies	912	0.5	0.7	0.7	0.7	0.7
22. Gross fixed capital formation	6,498	3.7	3.9	4.1	4.2	4.2
23. Other	5,706	3.3	3.6	3.4	3.2	3.0
24. Total Expenditure (=17 to 23) (=7)	59,738	34.2	36.1	37.0	36.9	36.5
Government Consumption	*27,919*	*16.0*	*16.5*	*17.2*	*17.5*	*17.2*

Source: Department of Finance. Figures may be affected by rounding.

[9] Capital Acquisitions Tax only. Capital Gains Tax is included in '12.b Current Taxes on Income, Wealth, etc', and Stamp Duty is included in '12.a Taxes on Production and Imports'.
[10] Interest, dividends, rent, etc.
[11] Total Taxes plus Social Contributions plus taxes paid directly to EU.

3.4 Cyclically-Adjusted Budget Balance and Fiscal Stance

Developments in the cyclically-adjusted budget balance (CABB) are presented in table 8 below. The estimates of potential output are based on the harmonised production function methodology developed by the EU Commission and the Member States. It should be noted that the figures presented below incorporate a change to the calculation of total factor productivity growth for Ireland, the impact of which is to lower the rate of potential growth from previous estimates.

By their nature, estimates of potential output and the resulting output gap are subject to uncertainty. In Ireland's case, this uncertainty is compounded by a number of factors, such as the openness of the labour market. In these circumstances, analysis of developments based upon such estimates – such as the CABB – need to be treated with caution.

Notwithstanding these caveats, estimates are presented below and these are based on the macro-economic and budgetary forecasts set out elsewhere in this Update. The elasticity of the budget balance to changes in GDP is assumed to be 0.4. Developments in the cyclically adjusted primary balance (i.e. excluding national debt interest payments) are also shown, as are developments in the CABB excluding contingency provision. The structural budget balance, defined as the CABB excluding one-offs, is presented also.

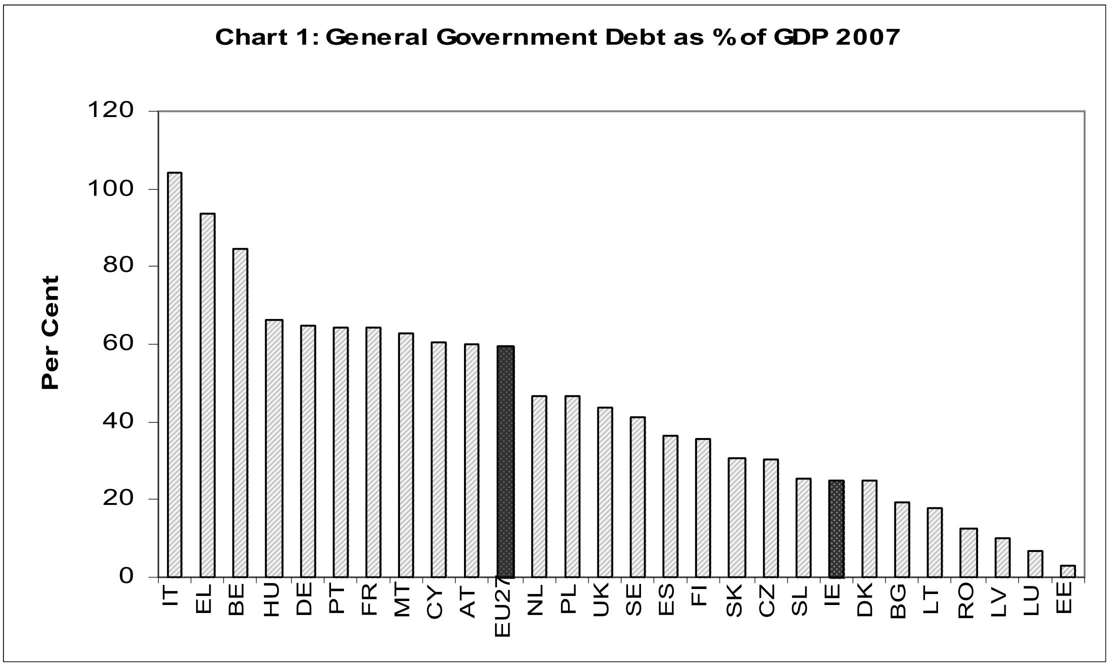
Table 8 – Cyclical Developments

% of GDP	2006	2007	2008	2009	2010
GDP growth	5.7	4.8	3.0	3.5	4.1
Actual balance	2.9	0.5	-0.9	-1.1	-1.0
Interest expenditure	1.0	0.9	1.0	1.1	1.1
One-off and other temporary measures	0.1	0.2	0.0	0.0	0.0
Potential GDP growth	5.8	5.1	4.0	3.7	3.4
- contribution of labour	2.0	1.7	0.9	0.8	0.6
- contribution of capital	2.0	1.9	1.7	1.6	1.6
- contribution of total factor productivity	1.6	1.4	1.3	1.2	1.2
Output gap (% potential output)	-0.3	-0.5	-1.5	-1.7	-1.0
Cyclical budgetary component	-0.1	-0.2	-0.6	-0.7	-0.4
Cyclically adjusted balance (CABB)	3.0	0.7	-0.3	-0.4	-0.6
Change in CABB		-2.3	-1.0	-0.1	-0.2
Cyclically adjusted primary balance (CAPB)	4.0	1.6	0.7	0.7	0.5
Change in CAPB		-2.4	-0.9	0.0	-0.2
CABB excluding contingency	3.0	0.7	-0.3	0.0	0.2
Structural Balance	2.9	0.5	-0.3	-0.4	-0.6

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

3.5 Debt Level and Developments

As indicated by chart 1 below, Ireland has one of the lowest debt-to-GDP ratios in the EU27.



Source: European Commission Autumn Forecasts 2007; Irish data: Department of Finance (estimates)

Over the forecast period 2008 – 2010, the gross debt level is expected to average around 27.4% 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 those assets, is estimated to be around 14% at end-2007.

Table 9 – General Government Debt Developments

% of GDP	2006	2007	2008	2009	2010
Gross debt[12 13]	25.1	25.1	25.9	27.6	28.7
Change in gross debt ratio	-2.3	0.0	0.8	1.7	1.1
Contributions to change in gross debt ratio					
Primary balance	3.9	1.4	0.0	-0.1	0.0
Interest expenditure	1.0	0.9	1.0	1.1	1.1
Stock-flow adjustment	2.9	2.1	1.2	2.0	1.7
Nominal GDP	-2.3	-1.6	-1.3	-1.4	-1.6
Net Receipts of Social Security Funds	1.4	1.5	1.4	1.5	1.4
Other factors influencing the debt ratio:					
Privatisation receipts	-0.1	n.a.	n.a.	n.a.	n.a.
Increase in local authorities debt	-0.2	0.1	0.1	0.1	0.1
p.m. implicit interest rate on debt	4.0	3.8	4.1	4.4	4.1

Source: Department of Finance

[12] The General Government debt ratio is measured on a gross basis, so liquidity held at year end will affect the gross debt.
[13] The GG debt ratio does not take into account the funds in the National Pensions Reserve Fund which at end September 2007 was equivalent to 11% of GDP.

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. In general terms, it is estimated that a 1% change in the growth rate of the economy would change the General Government Balance (GGB) by about 0.4 percentage points of GDP in the short-run. However, this is only a general rule, as the magnitude of the impact on the GGB will vary according to the cause of the change in growth.

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. First, the estimates should be seen as indicative and are subject to considerable uncertainty. Second, it is assumed that there is no fiscal policy response to the changed budgetary position over the period. In reality such a response would occur if desirable in the interests of economic or budgetary sustainability, or if required under the terms of the Stability and Growth Pact. Finally, it should be noted that the results differ depending on the type of scenario modelled.

4.3 Sensitivity of Budgetary Projections to Different Scenarios and Assumptions

Two alternative causes of a 1% change in economic growth are modelled using the Economic and Social Research Institute's macroeconomic model HERMES. The results are presented in table 10.

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

	2008	**2009**	**2010**
Baseline GDP Growth (%)	3.0	3.5	4.1
GGB Range (% GDP) (including contingency)	-0.9	-1.1	-1.0
1% change in the rate of growth due to a change in interest rates			
Cumulative impact of 1% change in growth on GGB (% GDP)	Up to 0.1 pp	Up to 0.4 pp	Up to 0.4 pp
GGB Range (% GDP)	-1.0 to -0.8	-1.5 to -0.7	-1.4 to -0.6
1% change in the rate of growth due to a change in world growth			
Cumulative impact of 1% change in growth on GGB (% GDP)	Up to 0.1 pp	Up to 0.2 pp	Up to 0.3 pp
GGB Range (% GDP)	-1.0 to -0.8	-1.3 to -0.9	-1.3 to -0.7

Source: Department of Finance

These estimates suggest that a 1% lower growth rate resulting from higher interest rates would lead to a deterioration in the GGB of about 0.4 percentage points of GDP in the short-run. This finding is broadly symmetrical in that higher growth as a result of lower interest rates would improve the GGB by a similar amount. The impact on the GGB in the first year is relatively small. However, as higher interest rates feed through into industrial costs, the magnitude rises to 0.4 percentage points of GDP (relative to the baseline) in the second year and remains at that level in the third year.

A change in world demand conditions would also have an impact on the growth rate of the Irish economy and hence on the public finances. Estimates suggest that a 1% increase in domestic growth resulting from stronger world output would improve the GGB by around 0.3 percentage points of GDP in the short-run. The impact in the first year is small (0.1 percentage points of GDP relative to the baseline) as it is assumed to take some time before the private sector is able to react and take advantage of the unexpected rise in world demand. The magnitude of the effect increases to about 0.2 percentage points of GDP in the second year, and to 0.3 percentage points of GDP in the third year, as private sector adjustment takes place. As the manufacturing sector accounts for a relatively smaller share of output today than in the past (due for instance to the growing importance of less import-intensive sectors such as construction and parts of services), the impact is less than it would have been some years ago.

4.4 Comparison with Previous Update

Table 11 compares this Stability Programme Update with the Programme of December 2006. GDP growth in 2007 is now estimated at 4.8%, compared to a forecast of 5.3%, in last year's Stability Programme Update. GDP forecasts for 2008 and 2009 have also been revised. GNP growth in 2007 is now estimated to be 4.2%, compared to a forecast of 5.3% in last year's Update.

The General Government Balance in 2007 is now projected at 0.5% of GDP, compared with 1.2% anticipated in the last Update.

Table 11 – Divergence from the Previous Update

	2006	2007	2008	2009	2010
Real GDP growth (%)					
Previous update	5.4	5.3	4.6	4.1	-
latest update	5.7	4.8	3.0	3.5	4.1
Difference	0.3	-0.5	-1.6	-0.6	-
General Government balance					
(% of GDP)					
Previous update	2.3	1.2	0.9	0.6	-
latest update	2.9	0.5	-0.9	-1.1	-1.0
Difference	0.6	-0.7	-1.8	-1.7	-
General Government Gross Debt					
(% of GDP)					
Previous update	25.1	23.0	22.4	21.9	-
latest update	25.1	25.1	25.9	27.6	28.7
Difference	0.0	2.1	3.5	5.7	-

Source: Department of Finance

Chapter 5 – Quality of Public Finances

5.1 Introduction

The ECOFIN Council of 5 June 2007 adopted conclusions in relation to the importance of the quality of public finances. This chapter and chapter 7 outline a range of measures to sustain improvement in the efficiency and outcomes of public spending and taxation in line with the objectives of the Stability and Growth Pact and the Lisbon strategy for growth and jobs. Recent developments in relation to reform and modernisation of the public service are also outlined.

5.2 Policy Strategy

The objectives set out by Government include achieving further significant, sustainable growth while operating responsible fiscal policy. Government policy seeks to build for the future by raising Ireland's productive capacity, particularly in terms of public infrastructure and ensuring high levels of high-quality employment, and in doing so to improve quality of life and achieve a more equitable society. In pursuit of these objectives fiscal policy has been directed towards:

- Underpinning incentives to reward effort and enterprise, consolidating the progress made in recent years;
- Ensuring that the share of national resources devoted to public investment will continue to be maintained at a high level;
- Improving a broad range of key day-to-day public services including:
  - Education at all levels;
  - Research and Development;
  - Health services;
  - Childcare;
  - Rates of social welfare and pensions payments; and
  - Overseas Official Development Assistance spending.
- Maintaining a pro-enterprise environment and reward work by keeping the overall tax burden low while increasing the fairness of the tax system.

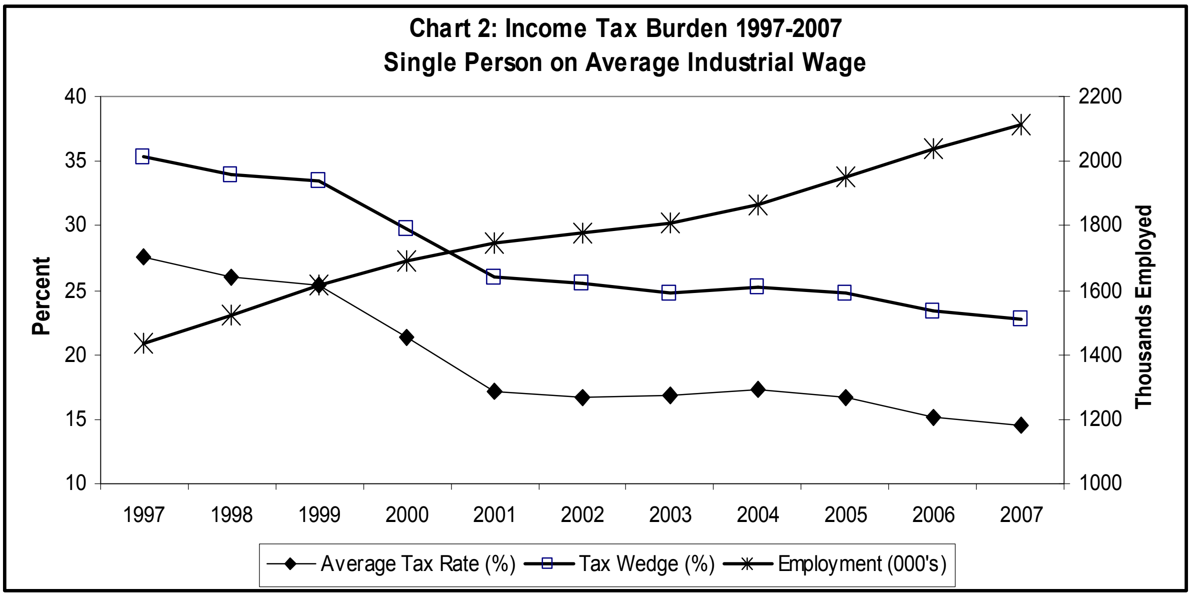
Delivery of the medium-term economic policy and investment framework as set out in the National Development Plan 2007 – 2013 is the key priority for the Government to raise our productivity, enhance our competitiveness and secure our future prosperity (see section 5.8).

The Government is committed to making significant progress in reaching environmental targets. It is implementing a comprehensive range of measures as set out in its new National Climate Change Strategy and initiating a carbon report with this Budget (see section 5.9).

5.3 Revenue Strategy

The Government continues to strive to build an equitable tax system which encourages economic growth, so as to ensure employment growth and continuing improvements in living standards for all. This is in line with the objectives of the Lisbon Strategy for growth and jobs.

The priority in recent Budgets has been to consolidate the employment-friendly environment established in Ireland over the last number of years. This has been achieved by maintaining the low tax burden on all, focusing resources towards those at the lower end of the income scale.



Source: Department of Finance

Chart 2 above shows that the burden of taxation on those earning the average industrial wage has fallen quite significantly over this period 1997 to 2007. Employment growth of 43% has been achieved between 1997 and the first three quarters of 2007. A combination of a number of elements contributed to growth in the labour force. These include demographic factors, in particular high net inward migration, and an increase in the female labour force participation rate, from below 40% in 1995 to 54% in the first three quarters of 2007. Labour market tax policies pursued by Government have played an important role in translating labour force growth into positive employment growth.

Efficiency of Tax Collection
At 31 March 2007, the total tax debt outstanding was €1,107 million which represents 1.8% of gross receipts collected by the Office of the Revenue Commissioners in 2006. This is one of the lowest percentages of any tax administration world-wide and compares to a total debt of 4.0% of gross receipts in 2000, 14% in 1995 and 26% in 1990.

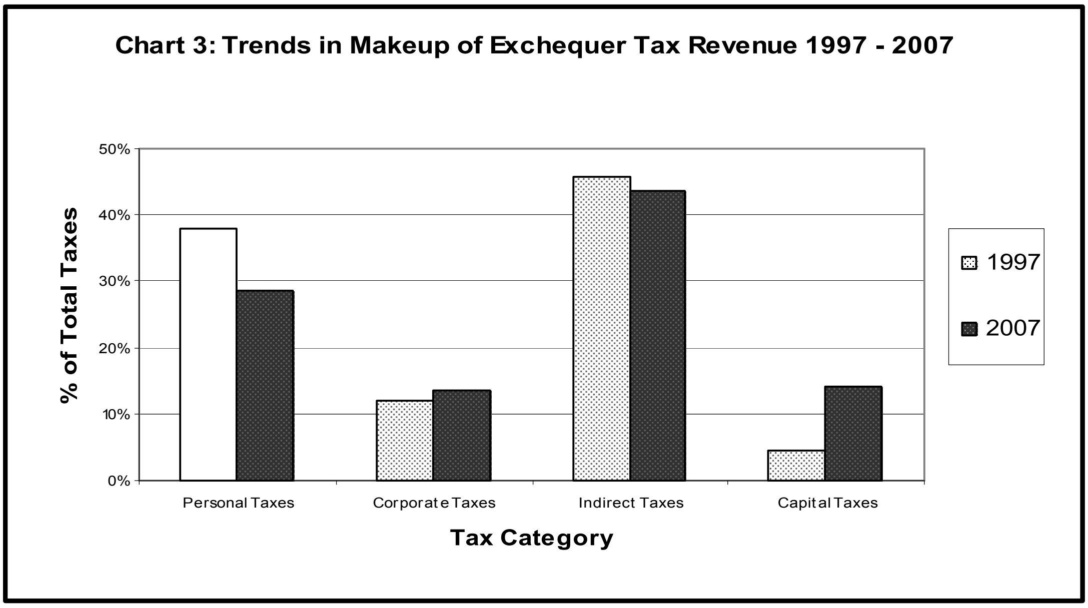
Of that tax debt of €1,107 million, 15% is under control, generally through an agreed instalment arrangement where the liable entity is given additional time to pay. 36% is under active collection while a further 21% is currently at enforcement. The remainder, 28% is under appeal and is not currently available for collection.

In the period since 1998, the Revenue Commissioners have collected almost €2.4 billion in one-off receipts from a number of special investigations up to the end of November 2007. These include investigations into the holders of bogus non-resident bank accounts for tax evasion purposes and evasion in relation to offshore assets, as well as a further major investigation into the use of investment-related life assurance products to hide undisclosed income. Aspects of these investigations are still ongoing.

Commission on Taxation
The Government proposes to establish a new Commission on Taxation very shortly, in order to review the efficiency and appropriateness of the Irish taxation system. The Commission will have a wide remit to consider the structure of the taxation system. It will begin its work early in the new year.

5.4 Changing Sources of Exchequer Tax Revenue 1997 – 2007

The evolution of the shares of Exchequer tax revenues since 1997 is indicated in chart 3 below.



Personal taxes as a share of total Exchequer tax revenues have declined over the period due to the lower income tax burden, particularly for those on lower incomes. The share of corporate taxes has risen in line with improved corporate profitability. The amount of total taxes accounted for by capital taxes has increased. In recent years this was largely as a result of activity in the property market. However capital taxes are expected to come in behind target in 2007 reflecting more recent developments.

5.5 Expenditure Policy

The *Broad Economic Policy Guidelines* for 2005 – 2008 include the general recommendation that Member States should *"re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, [...] ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages"* (Guideline no.3). Over the past number of years, Ireland has developed a range of initiatives aimed at managing and monitoring public expenditure in a more strategic manner, with a focus on *(i)* prioritising economic investment to support growth; *(ii)* efficiency and value-for-money; and *(iii)* effectiveness in the delivery of policy outcomes.

The Government is committed to an expenditure policy which contributes to the achievement of sustainable economic and social development by maintaining the growth in current public expenditure broadly in line with the resources available, while seeking to optimise value for money from that expenditure. Accordingly, the rate of growth in total public expenditure for 2008 will be 8.6% which is significantly lower than the rates of 12% and 13% in 2006 and 2007 respectively. This reflects the lower projected increase in revenue in 2008 as the nominal growth rate of the economy eases. Resources have been prioritised for the key areas of health, education, social welfare and public investment to address infrastructural deficits and tackle environmental issues.

Value for money framework

Building on the reforms of recent years, further progress was made in 2007 in developing a robust value for money framework designed to ensure that there is:

- more effective and efficient allocation and management of resources by Government and Ministers, Departments and Agencies;
- better value for money for the taxpayer;

- greater accountability to the Oireachtas (Parliament) and the public through the introduction of "existing level of service" expenditure information in the Pre-Budget Outlook prior to the publication of increased expenditure in the Budget.

A comprehensive value for money framework is now in place which includes:

- The rolling multi-annual capital envelopes for public capital investment which provide medium-term certainty for Government Departments and agencies in planning and managing their capital programmes and projects, consistent with the roll-out of the *National Development Plan 2007 – 2013*;
- Revised guidelines for the appraisal and management of capital expenditure;
- Public-Private Partnerships (PPPs) to procure suitable projects;
- Reforms to public procurement, including moving to fixed-price contracts as the norm;
- Additional value for money measures on procurement, ICT projects and consultancies announced in October 2005 and codified in a Department of Finance circular letter in January, 2006;
- New arrangements for Value for Money Policy Reviews;
- A Central Expenditure Evaluation Unit, established in 2006 in the Department of Finance, to promote best practice in relation to appraisal and evaluation generally and compliance by Departments and Agencies with the enhanced Value for Money requirements;
- Reform of the Estimates and Budgetary process announced in September 2007, which has introduced a unified Budget with expenditure and revenue decisions being made at the same time;
- Annual Output Statements (AOS) produced by individual Ministers to accompany their Estimates of Expenditure, setting out details of the results expected to be delivered with the public funds being sought from the Dáil.

See chapter 7 for more details of these and other related reforms.

5.6 Expenditure 2008 – 2010

The Budget Estimates for 2008 provide for resources of €53.3 million for day-to-day services, an increase of 8.2% over 2007. This level of increase in current spending is significantly lower than in previous years reflecting the outlook for more moderate economic growth going forward, and in line with the imperative of maintaining the public finances on a sustainable path. Within the total current provision, key priority areas have been targeted:

- an additional €1.1 billion (7.7%) in gross current spending for health services;
- an additional €611 million (7.0%) in gross current spending for education and science; and
- an additional €1.51 billion (9.8%) in gross current spending for social welfare.

The Government is committed to reaching a target for Official Development Assistance (O.D.A.) of 0.7% of GNP by 2012 and an interim target of 0.6% of GNP by 2010. In keeping with this objective, an additional €83 million (an increase of 11%) is being provided to bring the level of provision for O.D.A. up to 0.54% of GNP in 2008.

As outlined in section 5.8 below, public capital investment into the medium-term is provided for in the *National Development Plan 2007 – 2013* which was published in January 2007. The Government is determined to maintain the high level of investment in Ireland's economic capacity and strategic infrastructure. Accordingly, in line with the Plan's provisions, the Budget Estimates provide for Gross Exchequer Capital investment in 2008 of €8.63 billion (an increase of 10.7% over the 2007 allocation), with an additional €358 million in PPPs funded by annual payments from the Exchequer. In addition, it is estimated that €535 million will be invested in user-charge PPP projects, mainly in the roads area.

Total General Government expenditure in 2008 will be 37.0% of GDP and 43.4% of GNP and will average 36.8% of GDP and 43.2% of GNP over the period to 2010. Table 7 in chapter 3 shows the development of public expenditure in General Government terms.

5.7 General Government Expenditure on Public Services

Against a background of economic and revenue growth over the past decade, 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 to reflect demographic growth in key cohorts such as children under 6 years of age and the elderly. The increase has also contributed to improvements in the quality of public services and outcomes, including the following specific examples:

- An enhanced range of services and supports has been put in place for persons with disabilities as part of the National Disability Strategy.

- There has been increased investment in the services for older people to facilitate their remaining in the community for as long as possible.

- The National Treatment Purchase Fund will have arranged treatment for over 72,000 patients by the end of 2007. This service has contributed to a reduction in waiting times for most common procedures to between 2-to-5 months, compared to 2-to-5 years before the advent of the Fund in 2002.

- In the Education area, the staffing schedule at primary level has been reduced from 29-to-1 to 27-to-1 since 2005, thereby reducing average class size. Nearly 3,500 additional primary teachers have been appointed since the beginning of 2005, and the Estimates include provision for an additional 1,100 teachers in 2008 to maintain the improved pupil-teacher ratio. An additional 300 post-primary teachers have also been appointed since 2005.

- The access to education for those with special needs has been improved, with 8,400 resource and learning support teachers in the school system to enable children with special educational needs and learning difficulties receive a proper level of educational services in mainstream classes. Alongside them, there are almost 9,000 special needs assistants (whole-time equivalents) meeting the care needs of these children to ensure that such children receive any necessary educational supports. The Budget Estimates provide for 670 additional special needs and language support teachers and 480 special needs assistants to take account of demographic changes and to improve services further.

- As regards the outcomes in terms of educational attainment, successive OECD International Tests (taken by 15 year olds) carried out under the Programme for International Student Assessment (PISA) have shown that Ireland ranks significantly above the OECD average in reading literacy and scientific literacy and the Irish results are not significantly different from the OECD average in mathematical literacy.

- Over the last ten years more than 39,000 student places have been created in third-level education, bringing the overall number of fulltime places to nearly 139,000.

- On Social Welfare, major advances have been made in addressing poverty and improving social welfare rates. Over the period 1998 – 2008 (inclusive), the State Pension (contributory) will have increased by 125% in nominal terms; this has gone a long way to improve the quality-of-life of older people in society.

- Other adult social welfare rates have also significantly increased over the same period, with the lowest rate increasing by almost 140% – well ahead of consumer price inflation – to a level of €197.80 per week, thereby maintaining and building upon the target level as set in the National Anti-Poverty Strategy (NAPS), which was achieved in 2007. In addition, child benefit rates have also been increased in very substantial terms. The rate for the first and second child has increased by 336% in nominal terms since 1997.

- EU Member States have committed to collectively increasing their overseas Official Development Assistance (O.D.A.) to 0.56% of GNI by 2010. Ireland's O.D.A. contribution has increased from 0.31% of GNP in 1997 to 0.54% of GNP in 2008, compared to an EU average contribution rate of 0.43% in 2006.

The 2008 Budget Estimates provisions will consolidate the increases in services achieved over the past years through a continued focussing on efficiencies in service delivery. The Estimates also include funding for further improvements in services including the following main areas:

- A social welfare package totalling €900 million in a full year to protect and support the weaker sections of our society including pensioners, carers, social welfare recipients and low income families.

- An increase of some €374 million over the pre-Budget estimates on Health to fund key improvements including for elder care; the disability sector; the rollout of cancer services; improvements in the Early Childcare Supplement; Immunisation programmes; and resources for innovative health service delivery projects.

- A total housing package of some €1.7 billion in 2008 which will facilitate the ambitious *Towards 2016* commitments and include funding for social housing, the Rental Accommodation Scheme, the Affordable Housing Purchase Scheme and under the Capital Loans and Subsidy Scheme (Voluntary and Co-operative Housing).

- An increase of €218 million Exchequer expenditure on Education compared to the pre-Budget allocation to be spent on various measures including the Primary Schools Building Programme, school transport, Special Educational Needs, measures aimed at tackling educational disadvantage and the School Completion Programme.

- A further €36.5 million allocated to the Science, Technology and Innovation Programme as part of the Government's commitment to promoting a competitive, knowledge-based economy, split between Enterprise Ireland & Science Foundation Ireland.

- An investment of almost €1 billion capital in public transport.

- €45 million extra capital investment in Water Services to continue infrastructural support for social and economic development.

5.8 Infrastructural Investment

National Development Plan 2007 – 2013

The National Development Plan 2007 – 2013 (NDP) was launched by the Government on 23 January 2007. The Plan is a new integrated and coherent seven-year investment strategy which underpins Ireland's strong commitment to investment in our economic and social infrastructure into the medium term. It sets out a blueprint and accompanying quantified investment programmes to achieve high level objectives in the following areas:

- Maintenance of a framework of macroeconomic and budgetary stability;
- Addressing economic and social infrastructure deficits;
- Supporting enterprise, innovation and productivity;
- Promotion of Social Inclusion;
- Balanced regional development;

- All-island economic and sectoral co-operation;
- Environmental sustainability; and
- Value for Money on delivery of programmes.

Investment under the Plan is grouped under five Priorities:

- Economic Infrastructure;
- Enterprise, Science and Innovation;
- Social Infrastructure;
- Human Capital; and
- Social Inclusion.

In relation to funding total investment under the Plan in the period 2007 – 2013 will amount to approximately €184 billion (current prices), of which €100 billion will be capital investment. This will allow for overall capital investment to be maintained at above 5½% of GNP over the period, a very strong commitment by EU and other international standards. The €184 billion overall investment is broken down as follows:

Economic Infrastructure - €54.7 billion
- includes transport, energy, environmental services and communications

Enterprise Science & Innovation - €20.0 billion
- includes Science Technology & Innovation along with a number of sectoral development programmes e.g. enterprise, agriculture, tourism.

Human Capital - €25.8 billion
- includes training and skills dev., school modernisation and higher education.

Social Infrastructure - €33.6 billion
- includes housing, health infrastructure, justice and sports, culture, heritage and community infrastructure.

Social Inclusion - €49.6 billion
- includes programmes for children, unemployed, lone parents, older people, people with a disability and groups such as migrants and travellers.

Table 12 - Composition of Funding in the NDP

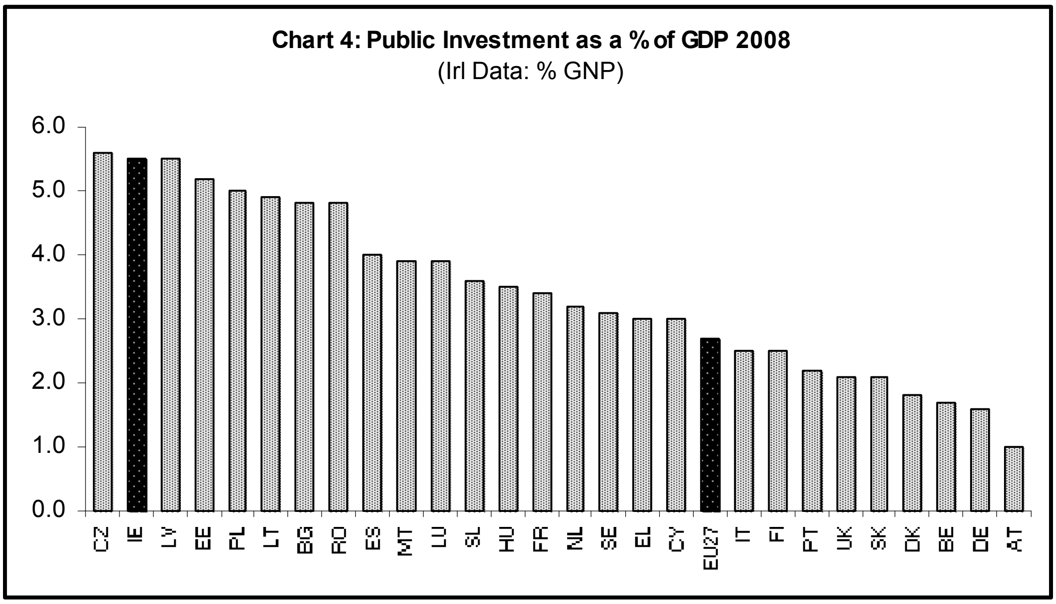
Source of Funds	**Current**	**Capital**	**Total**
Exchequer:	€79.5 billion	€63.6 billion	€143.1 billion
PPPs:		€13.4 billion	€13.4 billion
Commercial State Bodies:	€0.3 billion	€15.7 billion	€16 billion
Local Authority Own Res:		€4.2 billion	€4.2 billion
Other*:	€3.8 billion	€3.2 billion	€7 billion
Total:	**€83.6 billion**	**€100.1 billion**	**€183.7 billion**

*Local Government Fund, Environment Fund and National Training Fund

In addition to the Sectoral Priorities, the NDP also sets out investment frameworks for the achievement of strategic policy goals specially in the areas of regional development; environmental sustainability; development of the rural economy; and all-island co-operation. These frameworks are to be incorporated into the implementation of the NDP.

Multi-Annual Envelopes
The introduction of the capital carryover facility has ensured that significant sums in unspent capital are available for spending the following year. The 2008 Budget Estimates provide that €126 million will be carried over from 2007 into 2008. Taking account of the impact of the capital carryover facility, total Exchequer spending on investment in 2008 is forecast to be 11.9% higher than in 2007.

The overall 2008 capital allocation provides for a total public capital investment of just under €9.0 billion. Some €8.6 billion of this is Exchequer capital and €358 million is PPP capital to be funded by annual payments from the Exchequer. Public investment will be maintained at above 5½% of GNP which is around twice the EU average. In addition, it is estimated that €535 million will be invested in user-charge PPP projects, mainly in the roads area, bringing overall capital investment to around 6% of GNP over the programme period. (See the Multi-Annual Capital Investment Framework at page I.97 of this volume.)



Source: European Commission Autumn Forecasts 2007; Irish data: Department of Finance (forecasts)

There are currently some forty-four major privately-financed projects at various stages of procurement or planning ranging from roads to environmental services, with twenty-five projects already operational or in construction, including education projects, tolled roads, housing redevelopment and waste water treatment.

Overall, the investment provisions contained in the 2008 Budget Estimates represent a strategic use of available resources to support sustained economic progress into the future.

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 2008 in these areas will amount to about €11 billion (6.5% of GNP) as against €3.6 billion in 1997. The investment can be broken down as follows:

- Education: €9.1 billion
- Research & Development: €892 million
- Employment Supports and Training: €965 million.

These will also be priority areas for investment under the National Development Plan 2007 – 2013.

Investment in Balanced Economic Development
The provision for gross Exchequer capital expenditure on the programme of decentralisation of Government departments and agencies is €160 million. This programme involves 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. See section 7.9 for details of progress.

5.9 Carbon Report

The Government is committed to making significant progress in reaching environmental targets. It is implementing a comprehensive range of measures as set out in its new National Climate Change Strategy which aims to bring Ireland in line with its Kyoto commitment to control greenhouse gas emissions. The Government will present an outline carbon report in conjunction with the annual financial budget, followed immediately by a report outlining Ireland's use of energy in the preceding year, the progress made in meeting the reduction targets, and government plans to meet the target in the following year. This Budget initiates this process.

Chapter 6 - Sustainability of Public Finances

6.1 Summary

A key objective of budgetary policy design is to ensure the sustainability of the public finances into the future. Sustainability is defined as the ability to meet projected public expenditure from available public funds over the long run. For many countries, including Ireland, a major concern in this respect is demographic change - the coming decades will see a marked rise in the share of older people and a fall in the share of the working age population.

This shift to an older population will give rise to a substantial increase in age-related public expenditure. Recent projections indicate that spending on pensions, health and long-term care will double between now and mid-century. A further consequence of demographic change is that the task of financing such spending will fall to a diminishing share of the population.

These trends imply that the sustainability of the public finances will come under increasing pressure. Indeed, the European Council and the European Commission consider Ireland to be at 'medium' risk when it comes to the long-run sustainability of the public finances[14]. As such – and notwithstanding initiatives such as the establishment of the National Pensions Reserve Fund and the Government's ongoing commitment to prudent budgetary planning, maintaining a low debt burden, growth-enhancing investment, and improving employment and labour force participation rates – it is clear that meeting future challenges will require additional policy responses and potentially difficult choices on our part. In making these choices, it will be important to recognise the trade-offs that exist so as to put in place an appropriate policy mix. This should aim to secure the sustainability of the public finances with minimum disruption to the wider economy.

Finally, it should be borne in mind that these challenges will not materialise in full for some time yet. Hence, we have a reasonable, but by no means indefinite, period in which to decide how best to address them.

6.2 Long-Term Budgetary Prospects including the Implications of Ageing

Ireland's demographic profile is set to change dramatically over the coming decades. While the overall size of the population is projected to increase, of greater importance from the viewpoint of the public finances is the projected change in its composition, particularly its increasing age. Projections presented in the recent Green Paper on Pensions indicate that the population share of those aged 65 and over will more than double between now and 2050, from 11% to 28%[15]. In contrast, the share of the working age population is expected to gradually decline from 69% to 57%. This means that we will move from having six people of working age for every older person today, to two to one by mid-century.

These projections take the results of Census 2006 as the starting point. A particular pattern for fertility, life expectancy and migration is then assumed[16]. The resultant picture of demographic change is broadly similar to that presented by EUROSTAT (see table 13) and other commentators.

This projected change in the composition of the population will impact on the public finances in two ways. First, as the population ages, age-related public expenditure will begin to rise. Projections carried out at EU level by the Economic Policy Committee and the European Commission provide an estimate of the magnitude of the impact that Ireland might expect in this respect (table 13). These projections indicate that public spending on pensions, health and long-term care will increase from

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[14] European Council (2007) *Council Opinion on the Updated Stability Programme of Ireland, 2006 – 2009* and European Commission (2007) *Economic Assessment of the Stability Programme of Ireland (Update of December 2006).*

[15] Green Paper on Pensions (chapter 3) - www.pensionsgreenpaper.ie.

[16] Ibid.

10.5% of GDP in 2005 to 19.6% by 2050. Although potential savings are projected in the areas of education and unemployment benefit expenditure, at 0.9 percentage points of GDP these are relatively minor.

Table 13 – Long-Term Sustainability of Public Finances

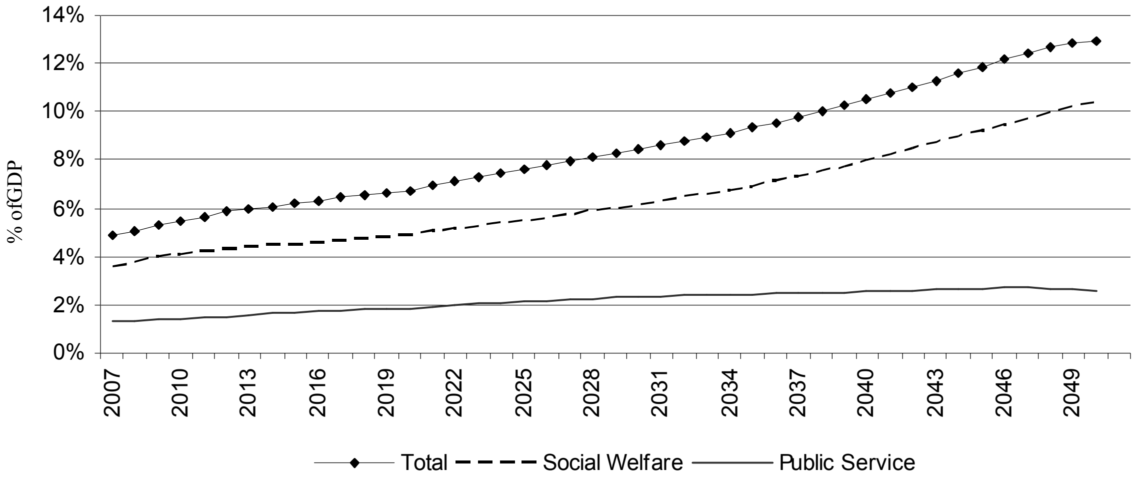
% of GDP unless otherwise stated	2005	2010	2020	2030	2040	2050
Age-Related Spending Projections (Economic Policy Committee & European Commission)[17]						
Total age-related expenditures (1) = (2)+(7)+(8)+(9)+(10)	15.2	15.4	17.1	18.8	20.7	23.3
Total pension expenditure (2) = (3)+(6)	4.6	5.2	6.5	7.9	9.3	11.1
Social security pensions (3) = (4)+(5)	3.4	3.8	4.5	5.5	6.8	8.4
Old-age and early pensions (4)	2.3	2.5	3.3	4.2	5.5	7.1
Other pensions (5)	1.1	1.2	1.3	1.3	1.3	1.3
Occupational pensions (Public Service) (6)	1.2	1.4	2.0	2.4	2.6	2.7
Health care (7)	5.3	5.5	5.9	6.4	6.9	7.3
Long-term care (8)	0.6	0.6	0.6	0.7	0.9	1.2
Education expenditure (9)	4.0	3.5	3.4	3.2	3.0	3.1
Other age-related expenditures (Unemployment benefit) (10)	0.7	0.6	0.6	0.6	0.6	0.6
Pension reserve fund assets	8.0	11.1	18.1	26.0	28.3	21.9
Underlying Assumptions (Economic Policy Committee & European Commission)[18]						
Labour productivity growth (y-on-y %)	3.3	3.8	2.2	1.7	1.7	1.7
Real GDP growth (y-on-y %)	5.7	5.2	3.0	2.1	1.4	1.6
Participation rate males aged 20-64 (%)	86.2	87.3	88.4	88.1	87.7	88.3
Participation rate females aged 20-64 (%)	64.5	68.5	73.3	75.3	75.3	75.6
Total participation rates aged 20-64 (%)	75.4	77.9	80.9	81.7	81.5	82.0
Unemployment rate aged 20-64 (%)	3.6	3.1	3.1	3.1	3.0	3.1
Population aged 65+ over total population (%)	11.2	11.8	14.8	18.4	22.2	26.2
Real interest rate (%)	3.0	3.0	3.0	3.0	3.0	3.0

At national level, the recently published Green Paper on Pensions projects that spending on public pensions will increase from around 5% of GDP today to 13% by 2050 (chart 5). In line with the EU projections, the bulk of this increase can be attributed to the Social Welfare component of the pension system, with the Public Service element accounting for the remainder. While the assets accumulated in the National Pensions Reserve Fund are expected to go some way towards easing funding concerns in this respect, it is estimated that they will fall short of future liabilities. Given this, the Green Paper discusses a range of measures that could help address the pensions funding challenge. The issues involved are being further considered as part of the Green Paper consultation process now underway.

[17] Economic Policy Committee & European Commission (2006) *The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004 – 2050).*

[18] Economic Policy Committee & European Commission (2005) *The 2005 EPC Budgetary Projections Exercise: Agreed Underlying Assumptions and Projection Methodologies.*

Chart 5 – Public Pension Spending Projections (Green Paper on Pensions)[19]



A second consequence of demographic change is that the task of financing increasing age-related spending will fall to a diminishing share of the population. By 2050, not only will pension, health and long-term care costs have significantly increased, but there will be just two people of working age per older person.

Taken together, these changes in the composition of the population imply a mismatch between the spending pressures facing the public finances and its ability to meet these pressures. As the above projections illustrate, demographic trends could lead to a doubling of spending on the principal age-related components of pensions, health and long-term care. Although technical long-run projections of the type presented in table 13 and chart 5 are subject to appreciable margins of error, they have considerable value in demonstrating the likely scale and timing of the coming fiscal challenge.

6.3 Sustainability Implications of Ageing

Indeed, the magnitude of the fiscal challenge Ireland faces in the decades ahead is such that the European Council and the European Commission consider us to be at 'medium' risk when it comes to the long-run sustainability of the public finances.

As such - and notwithstanding the initiatives taken to date (see section 6.4) – safeguarding the public finances into the future will require additional policy responses on our part. In this context, it should be borne in mind that our demographic profile will remain relatively favourable for some time yet. Thus, we have a reasonable, but by no means indefinite, period in which to decide how best to address future challenges. In broad terms, the available options are to:

- Raise taxes and / or reduce non age-related spending;
- Ease upward age-related spending pressures;
- Increase the share of the population at work;
- Improve the economy's productive capacity and competitiveness;
- Increase private savings.

Overall, given the scale of the task, it is unlikely that any one of these options will be sufficient to secure the long-term sustainability of the public finances. Instead, a combination of some or all will be required. When considering which policy responses to pursue in this regard, due attention should be paid to the impact of the various options and their timing on the wider economy.

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[19] Green Paper on Pensions (chapter 3) - www.pensionsgreenpaper.ie.

6.4 Policy Strategy

While further policy responses will be required going forward, a range of measures designed to take account of long-term fiscal pressures, along with the welfare needs of older members of society, have already been put in place. These are set out below. As pensions are expected to account for the majority of the projected increase in age-related spending, a particular focus has been placed on initiatives in this area. The framework for longer term pension policy, which the Government will develop in response to the consultation process on the Green Paper, represents the next important step in this respect.

In addition, Government strategy remains committed to prudent budgetary planning, maintaining a low debt burden, investment, and improving employment and labour force participation rates so as to support the economy's longer term growth potential.

The National Pensions Reserve Fund: The NPRF was established in 2000 with the objective of pre-funding in part the future Exchequer cost of Social Welfare and Public Service occupational pensions. A statutory obligation was placed on the Exchequer to pay a sum equivalent to 1% of GNP into the Fund each year from 2001 until at least 2055, with draw-downs prohibited prior to 2025. The market value of the Fund at end September 2007 was €21.26 billion or approximately 13% of GNP.

A major reform of public service pension provision: Ongoing since 2004, reforms implemented so far have, in relation to most new public servants, allowed for the raising of the minimum pension age from 60 to 65 and for the removal of a compulsory retirement age for most new public servants. A cost-neutral early retirement scheme with actuarially reduced benefits has also been introduced. Work in respect of public service pension reforms was further advanced during 2007 with a view to potentially bringing additional measures before Government in due course. Upon its completion, it is anticipated that the overall reform package will ensure a sustainable public service pensions position.

Green Paper on Pensions: In accordance with the social partnership agreement 'Towards 2016', the Government published a Green Paper on Pensions in October 2007. The Green Paper is a discussion document covering all aspects of the pension system – social welfare, public service and supplementary provision. It builds upon the 'National Pensions Review' and the 'Special Savings for Retirement' report published by the Pensions Board in 2006. The sustainability of Ireland's pension system from a financial, economic and social perspective remains the key objective. The Government will respond to the consultation process on the Green Paper (which is actively underway) by developing a framework for longer term pensions policy.

Incentives for private pension provision: On top of existing incentives to encourage private pension provision, the new Programme for Government undertakes to develop proposals in the context of the Green Paper on Pensions, and in consultation with the social partners, to provide an SSIA type scheme to make supplementary pension provision more attractive to those on lower incomes. The 'National Pensions Policy Initiative' (1998) set a target to raise supplementary pension coverage to 70% of the workforce aged 30 and over. The Quarterly National Household Survey 'Module on Pensions' published by the CSO for the last quarter of 2005 indicates that coverage for the target group amounted to 61.8%, an increase of 4 percentage points since 2002.

Actuarial Review of the Social Insurance Fund: The Social Insurance Fund is subject to five-yearly actuarial reviews to ensure that its contribution to long-term budgetary policy remains effective. The latest review – published in October 2007 – sets out the position of the Social Insurance Fund as at 31 December 2005 and provides projections of future contribution income to, and benefit outgoings from, the Fund up to 2061. The review will be used to inform the ongoing development of social insurance policy in Ireland and will also feed into the consultation process on the Green Paper on Pensions.

Health Service Reform Programme: The Health Service Reform Programme announced in June 2003 aims to create 'a health service that provides high quality care, better value for money and improves health care management'. Implementation of the various reforms is ongoing to ensure that the Health Service Executive delivers quality service commensurate with the public expenditure health absorbs.

Financing long-term care: The Inter-Departmental Group of senior officials which was jointly established by the Ministers for Health & Children and Social & Family Affairs is continuing to work on proposals for the future financing of long-term care. Drawing on work carried out by this group, and in line with principles agreed with the social partners under 'Towards 2016', the Government has announced the 'Fair Deal', a new scheme for long-term care which will be operational from January 2008.

Provision of childcare: A National Childcare Investment Plan was introduced as part of Budget 2006. It is embedded in the National Development Plan 2007 – 2013 under the Social Inclusion Priority with an allocation of €1.3 billion under the National Childcare Investment Sub-Programme. This measure is aimed at increasing the number of childcare places available so as to support female labour force participation.

The National Development Plan 2007 – 2013: Launched in January 2007, the investment in infrastructure, education, science technology and innovation set out in the National Development Plan 2007 – 2013 will help to strengthen the knowledge base and productive capacity of the economy so that it is better equipped to meet the challenges ahead.

Chapter 7 – Institutional Features of Public Finances

7.1 Introduction

This chapter sets out developments in relation to reform of the Estimates and Budgetary Process, within a medium-term budgetary framework consistent with the Stability and Growth Pact, and outlines recent improvements in the arrangements for managing public expenditure. These reforms and improvements will enhance the quality of public expenditure management and public accountability.

7.2 Reform of the Budgetary and Estimates Process

In March 2007, the Minister for Finance engaged with the Finance and Public Services Committee of the Dáil (the lower house of parliament) on the economic and fiscal background to the current and following two budgets as set out in the Stability Programme Update. This useful practice will be continued in March 2008 on the basis of today's Budget and this Stability Programme Update, and established as an ongoing feature of the annual budgetary process.

Also in March 2007, individual Ministers produced their first Annual Output Statements (AOS) to accompany their Estimates of Expenditure, setting out details of the results expected to be delivered with the public funds being sought from the Dáil. The AOS sets this performance information in the context of the High Level Goals of the Departments and Offices as outlined in their Statements of Strategy, and reinforces the re-focusing of parliamentary and public scrutiny away from looking solely at the financial inputs to include the corresponding data on public service outputs. From 2008 the AOS's will include information on what has actually been achieved in the previous year (as compared with the target outputs for that year), as well as setting out new output targets for the year ahead.

In September 2007 the Tánaiste and Minister for Finance announced the move to a Unified Budget, whereby all of the key announcements on both the spending and the revenue side of the Budget are announced together on Budget day, in early December each year. This reform is also designed to facilitate the Government in bringing forward proposals for future service improvements within a planned, progressive and sustainable overall framework, fully consistent with the Government's obligations under the Stability and Growth Pact.

In this context, the Pre-Budget Outlook (PBO) – which was first published in October 2006 to set out the medium-term economic and fiscal context for the December Budget – was expanded in October 2007 to show full detailed pre-Budget Estimates of Expenditure for the year ahead. The pre-Budget Estimates show the estimated cost of maintaining the existing level of public services in the year ahead, and in this way facilitate transparency regarding the actual resource allocation decisions made in the Budget. Today's 2008 Budget includes the corresponding detailed Budget Estimates showing the full allocations for the year ahead, thus providing full details on where resources are to be allocated, alongside the general budgetary data spelling out how these services are to be funded. This overall approach represents a more rational, relevant and coherent approach to budgetary decision-making.

7.3 Multi-Annual Capital Investment Framework

The multi-annual capital investment framework, introduced in 2004, is now established as the basis for medium-term planning and provision for capital investment. A new multi-annual envelope was published with the launch of the new National Development Plan 2007 – 2013 in January 2007 and sets out a comprehensive investment framework and strategy for the Plan period. Today's Budget includes the updated five-year capital envelopes for the period 2008 – 2012 (see page I.97), taking account of the precise capital allocations for 2008 set out in the 2008 Budget Estimates.

Public Private Partnerships

There is a provision of €358 million for PPP/NDFA capital funded by unitary payments from the Exchequer in 2008. The new capital envelope published on Budget Day sets out a five-year investment framework which includes targets for PPP investment. The NDP target for PPP investment (including PPPs funded by user charges) represents an average of 7.2% of total investment over the seven years of the Plan.

Legislation has been enacted to give effect to the July 2005 Government decision to consolidate the relevant skills and capacity required to support PPP procurement in the Central Government area into a specialised "Centre of Expertise", located in the National Development Finance Agency (NDFA). The Centre of Expertise will undertake the procurement of projects on behalf of Departments /Agencies (with the exception of roads and rail areas and the environment area where existing arrangements will continue to apply). This approach is designed to give impetus to the PPP process and increase deal flow.

Departments/Agencies advise that some 69 PPP projects, including 12 operational and 13 in construction, each with an estimated capital value over €20 million, have reached the stage of appointment of client advisors or later.

Management of Capital Programmes

Under the general conditions of sanction for the multi-annual capital envelopes, Departments and agencies are required to comply in all cases with the Department of Finance guidelines for the appraisal and management of capital projects, public procurement and value for money requirements.

All projects under capital programmes or included in business plans must be subject to project appraisal under the Department of Finance Capital Appraisal Guidelines as amended by the Department of Finance VFM circular of 25 January 2006.

The main requirements in this regard are as follows:-

- Projects involving minor refurbishment works, fit outs etc. with a value of less than €0.5 million will undergo a simple assessment.

- Projects between €0.5 million and €5 million will be the subject of a single appraisal, comprising elements of preliminary appraisal (to determine if a project justifies more detailed consideration) and detailed appraisal (a detailed assessment to determine if a project should go to planning and implementation stages).

- A preliminary appraisal and a full detailed appraisal will be carried out for all projects costing over €5 million. These larger projects will undergo a more sophisticated analysis with projects over €30 million being required to undergo a full cost benefit analysis at detailed appraisal stage.

- All capital programmes with an annual value in excess of €50 million and of 5 years duration or more are required to be evaluated at the beginning and mid-point of each 5 year cycle, unless otherwise agreed with the Department of Finance.

- The new guidelines also provide for a clearer definition of the respective roles and responsibilities of all involved in the management and appraisal of capital programmes and projects: Government, Ministers, the Department of Finance, Government Departments and public bodies.

- Departments and agencies must put in place formal structures and systems to report regularly to their management on the evaluation of projects prior to approval, and on progress on the management of capital projects and capital programmes.

- They must also arrange to carry out spot-checks for compliance with the capital appraisal guidelines and report on these and on progress generally under their capital envelopes to the Department of Finance.

- An individual must be appointed Project Manager to manage each major project.

- Departments and Offices must report on progress on major projects against budget and timescales in their annual reports.

- Peer review arrangements must be put in place for all major ICT projects.

In the context of continuing high levels of public investment, the implementation of the new guidelines and subsequent better management of projects has been effective in ensuring that major capital projects come in within Budget and on or ahead of schedule

7.4 Public Expenditure Management

Spending on day-to-day services is planned and managed within an overall three-year fiscal framework while, since 2005 with the introduction of five-year rolling capital envelopes, capital investment has been planned and managed on a multi-annual basis (see section 5.8).

The Government is committed to ensuring that expenditure, having been allocated in line with identified priorities, is subsequently managed strictly in line with the settled amounts. Accordingly, the Government has put in place arrangements for the ongoing monitoring and control of expenditure, including the following:-

- The publication in January of monthly expenditure profiles for the year ahead, consistent with the Budget Estimates, against which progress is monitored;
- Reporting to Government on a monthly basis on emerging trends and issues in relation to the public finances;
- Bi-monthly reporting to Government by the four Departments with the largest allocations for current spending and by all Departments with capital spending in excess of €250 million;
- Any increase in the Estimates provision requires parliamentary approval.

These arrangements for management and control of public expenditure have proven to be effective in ensuring that expenditure is delivered in a controlled and programmed manner. For the fifth year in a row expenditure in 2007 is forecast to be close to the profiled amount.

Table 14– Measuring Expenditure Management

Year	Variance: Budget Estimate v. Outturn	Variance as a % of GNP
2000	1.7%	0.4%
2001	1.5%	0.4%
2002	-0.4%	-0.1%
2003	-0.3%	-0.1%
2004*	-1.3%	-0.4%
2005*	-1.4%	-0.4%
2006	-2.0%	-0.6%

* The outturn in the years 2004, 2005 and 2006 includes capital carryover of €237m, €289m and €159m respectively which was carried into 2005, 2006 and 2007 under the capital carryover arrangements in accordance with Section 91 of the Finance Act 2004. Source: Department of Finance.

7.5 Procurement Management Reform including Construction Procurement

Procurement Management Reform – goods and services

Effective and efficient procurement policies, procedures and practices in public sector bodies can have a significant impact on obtaining value for money in the purchase of goods and services by the State. The 2005 National Public Procurement Policy Framework requires that a process of procurement management reform should be one of the key strategic priorities of public service bodies. Procurement management reform aims to improve procurement policies and procedures through a process of analysis and planning. Public sector bodies are required to analyse their procurement structures and practices and adopt improved procurement practices and procedures though the development of a Corporate Procurement Plan. These plans should provide targeted and strategic direction to procurement planning in public bodies. The Department of Finance is providing practical assistance to public bodies in the development and completion of these plans.

Construction Procurement Reform

The Government agreed to introduce significant changes involving fixed-price lump-sum public sector contracts to complement the rolling multi-annual investment envelopes and to help minimise cost overruns, facilitate early project delivery, and provide better value for money for the State. The changes involve the introduction of new Standard Forms of Construction Contracts with optimal risk transfer to contractors who are best placed to manage them. A suite of five new Forms of Construction Contracts for public works has been developed comprising traditional (employer design) contracts for civil engineering and building works and "design and build" contracts for civil engineering and building works. The contract conditions are designed to help achieve greater cost certainty, better value for money and timely and more efficient delivery of public works projects. Under the new arrangements, the contract price in relation to construction inflation will remain fixed for three years.

Standard Conditions of Engagement for Construction Consultants have also been developed in conjunction with the development of the new construction contracts. These Conditions and associated guidance are structured and balanced in a way that incentivises more efficient and effective consultant performance to better protect the public interest. The Conditions and guidance also change the fee payment mechanism from a negotiated percentage to tendered fixed price lump sum basis as the norm while not compromising on quality.

Parallel with the introduction of these new contracts a supporting guidance framework has also been developed for public bodies and a training programme, for public sector personnel and consultants using the new contracts, has been implemented.

The new contracts and arrangements became operational in early 2007.

7.6 Value for Money from Public Expenditure

The Value for Money and Policy Review initiative was introduced by the Government in June 2006. Under this initiative, the Government approved some 90 formal Value for Money Reviews to be carried out by Departments and Offices over the period 2006 – 2008. The initiative also includes all other Policy Reviews conducted and commissioned by Departments which impact on value for money. Each Department's and Office's programme of formal reviews focuses on significant areas of expenditure and major policy issues and, as a general rule, has a minimum indicative coverage of 10-15% of their respective Budgets. The reviews when completed are normally published and submitted to the relevant Select Oireachtas (Parliamentary) Committee for consideration.

To promote best practice in evaluation and project appraisal and to verify compliance by Departments and Agencies with value for money requirements, the Central Expenditure Evaluation Unit was established in the Department of Finance in 2006. The Unit has focussed initially on ensuring that Department of Finance frameworks in relation to the appraisal and management of programmes and projects are being implemented and on overseeing and supporting implementation of the ongoing Programme evaluation under the Value for Money and Policy Review initiative. The Unit also has responsibility for organising ongoing programme evaluation under the National Development Plan 2007 – 2013 and will be rolling out a programme of evaluations over the period of the plan starting in early 2008.

7.7 Public Service Pay – Modernisation and Service Delivery

Since the Social Partnership process began in 1987 there have been seven agreements. The current Social Partnership Agreement, ***Towards 2016***, has a ten year perspective in terms of economic and social developments. The pay and related elements will be reviewed more regularly - the initial pay agreement covers 27 months.

General Public Service Pay Trends
On public service pay, the more recent national agreements have restored stability to the public service industrial relations scene. The year-on-year level of increase in the Exchequer pay bill is coming down, from 18% in 2001 to a projected increase of some 6.2% in 2008.

Public Service Pay Deal and link to Modernisation
The new agreement *Towards 2016* provides for a 10% increase to be paid at various stages over 27 months. In the Public Service a five month pay pause was agreed. The increases applied so far are:

- 3% from 1 December 2006;
- 2% from 1 June 2007;

with two remaining increases to apply in 2008 as follows:

- 2½% from 1 March 2008; and
- 2½% from 1 September 2008.

The agreement provides that these pay increases are linked to a robust agenda of measures to improve the effectiveness and efficiency of public services. This was critically important for the Government. As with the previous agreement, a performance verification process was put in place within the Public Service and the payment of the various phases of the increase are contingent on the satisfactory implementation of the agenda for modernisation set out in the Agreement, maintenance of stable industrial relations and absence of industrial action in respect of any matters covered by the Agreement.

The Public Service Benchmarking Body is currently carrying out a benchmarking review of the pay of public service employees and is to report at the end of the year. A parallel benchmarking process was carried out in relation to the pay of the craft grades and the related non-nursing and general operative grades. The consultant's report on the pay of craft workers was presented to management and unions on 15 June 2007. Discussions are ongoing in relation to the report. The question of the implementation of the outcome of the benchmarking processes will be discussed by the parties in the context of discussions on whatever arrangements on pay and conditions are to be put in place on the expiry of this Agreement. The Benchmarking Body is due to report back at the end of the year.

Modernisation
A programme of modernisation of each sector of the public service has been under way for more than ten years. This has been underpinned by legislation and by putting in place several important innovations such as performance management development systems, management information systems and quality customer service initiatives. This process has resulted in real improvements in public services and there is now a well-established acceptance by public servants of the need for co-operation with further modernisation and flexibility. These improvements, and the extent of co-operation being delivered, have been verified by the sectoral verification groups referred to above which assess if the pay increases are warranted.

The modernisation measures agreed under the current agreement, designed to ensure that work is organised to deliver high quality services to the public, include the increase across the public service of open recruitment at senior levels as a means of gearing public service organisations up for the challenges ahead, including coping with an increasingly aging workforce; continued greater use of competitive processes for promotion purposes and a range of measures to streamline terms and conditions and to support better mobility and workforce planning.

Perhaps the most noteworthy of the changes agreed is a clear commitment to outsourcing of work where necessary to deal with temporary pressures of work or peaks or in order to avoid excessive delays in the delivery of services. Work can also be outsourced by agreement in other cases, with provision for reference to the public service sub-group of the National Implementation Body and if necessary to the Labour Court or Arbitration Board.

Other elements include co-operation with the introduction of shared services between public service and related organisations; discussions to be held to give effect to the commitment to the provision of certain services outside normal hours; and acceptance of the use of staff redeployment as a means of addressing emerging work needs, and to team and cross-organisational working.

There are other measures specific to different sectors of the public service.

OECD Review of the Irish Public Service

The Public Service Modernisation Programme is also being driven through other central initiatives which include a comparative review which is being carried out by the OECD and a programme of organisational reviews.

The OECD Review focuses on two key tasks:-

- To benchmark the Public Service in Ireland against other comparable countries, including identification of appropriate measures to compare the productivity and effectiveness of the Irish system, or discrete elements of it, against comparable international best practice, and
- To make recommendations as to future directions for Public Service reform which will support the Irish Government's drive for delivery of world class services to the citizen, within existing resources commitment, and contribute to sustainable national competitive advantage.

This Review marks a new phase in the sustained reform of the Public Service over the last decade and covers the whole of the Public Service, examining the effectiveness of arrangements through which government objectives are translated into outputs and outcomes. It is also focuses on the connections between the different sectors including the links between Departments/Offices and Local Government, Health and Education Sectors, with a particular focus on delivery of quality public services.

Capability Reviews

The Organisational Review Programme was approved by Government earlier this year. The purpose of the ORP is to provide organisations with a robust mechanism for assessing their capabilities and strengths in a number of key areas including service delivery, leadership, technology, financial management, project management to deal with the challenges that they face. The Organisational Reviews will be overseen by a new Committee, which will be made up of independent external members and senior public service figures, and the Committee will report directly to the Taoiseach.

7.8 Public Sector Numbers

The Government remains committed to controlling public sector numbers as part of its approach to managing public expenditure and securing better value for money. The Government has maintained the line that Departments and Agencies are as a rule required to deliver programmes from within their existing complement of staffing resources, with any additionality confined to what is necessary in terms of improving frontline and essential services.

7.9 Decentralisation

At the end of August 2007, over 3,000 staff had been assigned to decentralising posts. In all, over 40% of decentralising civil service posts have now been filled by staff that have either relocated or are in the process of being skilled up in their new role. Almost 1,300 of these are currently in place, in 20 new locations, while the remainder are being trained in advance of decentralisation to a new location, as soon as accommodation becomes available. In addition to these 20 locations there are a further 9 locations in which Agencies have established a presence. The total number of agency posts already relocated is approximately 200. It is envisaged that by the end of 2007 public services will be delivered from 33 of the decentralisation towns with approximately 2,000 staff transferred. The precise numbers moving within that time frame will depend on the availability of property as well as timeframes for completion of fit out and installation of necessary ICT (information communications technology) and telecommunication cabling and equipment.

ANNEX 1:

Basic Assumptions

Table 15 below sets out the European Commission's assumptions regarding key external variables.

Table 15 – Basic Assumptions

	2007	2008	2009	2010
Long-term interest rate (annual average)	4.3%	4.4%	4.5%	4.5%
USD/€ exchange rate	1.36	1.42	1.42	1.42
Nominal effective exchange rate (% change)	2.4	1.2	0.0	0.0
World GDP growth (excl. EU) (%)	5.6	5.3	5.4	5.4
EU27 GDP growth (%)	2.9	2.4	2.4	2.4
Growth of relevant foreign markets (%)	5.9	5.4	5.7	5.7
World import volumes (excl. EU) (%)	7.8	7.1	7.7	7.7
Oil Prices (Brent, USD/Barrel)	70.6	78.8	76.0	76.0

Source: European Commission

Supplementary Data

(In accordance with the guidelines on the format and content of Stability and Convergence Programmes. Indicators in bold are compulsory data).

Table 1a – Macroeconomic Prospects

	2006	2006	2007	2008	2009	2010
	€ million	*rate of change*	*rate of change*	*rate of change*	*rate of change*	*rate of change*
Real GNP	144,504	6.5	4.2	2.8	3.3	3.9
Nominal GNP	149,129	9.9	7.5	5.4	5.8	6.2
Real GDP	170,760	5.7	4.8	3.0	3.5	4.1
Nominal GDP	174,704	8.2	7.6	5.5	5.9	6.3
Components of real GDP						
Private consumption expenditure	80,823	5.7	6.6	3.8	3.9	4.0
Government consumption expenditure	24,074	5.3	4.8	3.6	2.9	2.8
Gross domestic fixed capital formation	43,377	3.1	1.5	-1.6	2.3	3.1
Changes in stocks (% GDP)	1,367	0.8	0.4	0.3	0.1	0.1
Exports of goods and services	137,969	4.4	6.8	5.6	5.2	5.0
Imports of goods and services	117,178	4.4	5.9	4.5	4.3	4.1
Contributions to real GDP growth*						
Final domestic demand		4.2	4.0	1.9	2.7	3.0
Changes in stocks		0.7	-0.4	-0.1	-0.2	0.0
External balance of goods and services		0.6	1.3	1.3	1.1	1.2

* Figures subject to rounding
Source: CSO (2006), Department of Finance (2007 – 2010)

Table 1b – Price Developments

	2006	2007	2008	2009	2010
	rate of change	*rate of change*	*rate of change*	*rate of change*	*rate of change*
GDP deflator	2.3	2.7	2.5	2.3	2.1
Private consumption deflator	2.1	3.4	2.9	2.1	2.1
HICP	2.7	2.8	2.4	2.0	1.8
Export price deflator (goods and services)	1.3	1.1	1.5	1.7	1.7
Import price deflator (goods and services)	3.3	2.0	1.7	1.8	1.9

Source: CSO (2006), Department of Finance (2007 – 2010)

Table 1c – Labour Market Developments

	2006 (000)	2006 %	2007 %	2008 %	2009 %	2010 %
Employment, persons	2,039	4.4	3.5	1.1	1.3	1.5
Unemployment rate (%)	93	4.4	4.6	5.6	5.6	5.5
Labour Productivity, per employee (GDP)		1.2	1.2	1.8	2.2	2.5

Source: CSO (2006), Department of Finance (2007 – 2010)

Table 1d – Sectoral Balances

	2006	2007	2008	2009	2010
	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending/borrowing vis-à-vis rest of world	-4.2	-4.4	-3.9	-3.5	-3.1
Statistical discrepancy	0.6	0.5	0.5	0.5	0.5

Source: CSO (2006), Department of Finance (2007 – 2010)