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IRELAND: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE DECEMBER 2007 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not. The most recent update of Ireland's stability programme was submitted on December 5 2007.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 3 March 2008. Comments should be sent to John Bohan (john.bohan@ec.europa.eu) and Janis Malzubris (janis.malzubris@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2007 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying "methodological paper" prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 19 February 2008. The ECOFIN Council is expected to adopt its opinion on the programme on 4 March 2008.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

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SUMMARY AND CONCLUSIONS

As part of the preventive arm of the Stability and Growth Pact, each Member State that uses the single currency, such as Ireland, has to submit a stability programme and annual updates thereof. The most recent programme, covering the period 2007-2010, was submitted on 5 December 2007.

After more than a decade of buoyant economic growth, per capita output in the Irish economy is among the highest in the European Union. This development was supported initially by strong export growth and more recently by rapidly rising domestic demand. During this period, public finances improved considerably, thereby allowing an impressive reduction in the public debt ratio. The economy is now facing a transition to a period of lower growth, characterised by a deterioration in competitiveness because of recent adverse productivity and price developments, and exacerbated by its exposure to the US and UK economies. On the domestic side, the growth slowdown reflects a return to more sustainable levels of activity in the residential construction sector, weakening asset values and rising unemployment. These developments could prove challenging for public finances, in spite of their overall strong position, given the foreseen weakening in tax revenues and the expectations for higher spending on upgrading public services generated by a prolonged period of budgetary surpluses.

The outlook for the public finances in the short and medium term also increases the urgency of addressing concerns about their long-term sustainability associated with population ageing. The recent Green Paper on Pensions concluded that the existing system is not sustainable without adjustments to the overall policy mix and that a combination of measures aimed at financing and reducing the size of the projected funding gap would be required. However, a protracted delay in implementing reform measures risks missing the current favourable demographic, economic and employment circumstances.

The macroeconomic scenario underlying the programme envisages that real GDP growth will fall from 4.8% in 2007 to 3.5% on average over the remainder of the programme period. Assessed against currently available information, this scenario appears to be plausible. It reflects mainly a large adjustment in the housing sector, offset to a certain extent by a continued recovery in net exports. The programme's projection for inflation could be somewhat on the low side for 2008, given recent developments in food and energy prices, but plausible thereafter. Inflation and competitiveness prospects in the outer years of the programme are supported by an improvement in productivity and the downward impact of a slowing labour market on wage pressures. The stability programme also envisages a fall in the external deficit, which is consistent with a weakening of domestic demand.

The programme's growth projections are broadly in line with the Commission services' autumn 2007 forecast. While the stability programme projects slightly lower GDP growth, the general deterioration in sentiment since the publication of the autumn forecast suggest that the risks are more negatively tilted. The programme projects a significant moderation in employment growth from the very high rates of increase observed in recent years, which were mainly met by high immigration, leading to some rise in unemployment in the near term. The projected evolution of the labour market is consistent with a period of below-trend growth, as the economy becomes much less dependent on the employment-intensive construction sector and output shifts more to meet external demand. The rapid slowdown in growth between the first and second halves of 2007 suggests an assessment of 'neutral times'. The economy seems to have entered economic 'bad times' in 2008, taking into account tax elasticities and remains in 'bad times' for the duration of the period 2008-2009.

For 2007, the general government surplus is estimated at 0.5% of GDP in the December 2007 stability programme, against a target of 1.2% of GDP in the previous update and 0.9% of GDP in the Commission services' autumn 2007 forecast. This downward revision reflects higher-than-programmed expenditure and a revenue shortfall, both of which were partly offset by a positive 2006 base effect. The revenue shortfall reflects in particular, the deterioration in the housing market.

Despite the weakening of the budgetary position in 2007, the medium-term objective (MTO), which is a balanced position in structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures), was reached by a large margin. The strategy outlined in the programme implies a weakening of the structural balance in 2008. Calculated according to the commonly agreed methodology, the structural surplus of ½% of GDP in 2007 is expected to turn into a deficit of around ½% of GDP in 2008 and to gradually worsen in subsequent years to a deficit of ¾% of GDP in 2010. The budgetary projections for 2009 and 2010 explicitly incorporate unallocated contingency provisions of, respectively, 0.4% and 0.8% of GDP. In 2009 and 2010, the revenue ratio is expected to continue declining, albeit less rapidly, while the expenditure ratio is projected to broadly stabilise in 2009 and to decline in 2010.

The risks to the budgetary projections in the programme appear broadly balanced in 2008. However, in subsequent years, there is a lack of information about what broad measures will be taken so as to contain current spending growth below nominal GDP growth. This is especially as regards the public wage bill and social transfer payments, both of which have increased substantially in recent years as a percent of GDP. Furthermore, there are also risks on the revenue side associated with previous commitments to reduce tax and social contribution rates. Moreover, while the inclusion of the contingency provisions in the budgetary projections could reflect prudent planning, it cannot be excluded that they may be used for future revenue-reducing and/or expenditure-increasing measures. Against these factors should be weighed Ireland's good track record, since the outturns for the fiscal balance have generally been better than projected in recent stability programmes.

In view of this risk assessment, while the MTO would be broadly reached in 2008, the fiscal stance thereafter could imply that the structural balance would move away from the MTO, which would not be in line with the Stability and Growth Pact. The budgetary stance in the programme may be insufficient to maintain the MTO after 2008 unless the margins foreseen in the programme as contingency provisions remain unused, implying a significantly better tax position and/or greater spending containment than shown in the programme.

Ireland appears to be at medium risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is well above the EU average, mainly as a result of a relatively high projected increase in pension expenditure over the coming decades, influenced in part by the maturation of the pension system. Yet, the gross debt ratio is well below 60% of GDP in 2007 and, in order to pre-fund part of future pension expenditure, assets are accumulated in the National Pension Reserve Fund. Developments in the structural balance, as projected in the programme until 2010, could put the sustainability of public finances at greater risk. In this context, maintaining high primary surpluses over the medium term and implementing further measures aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risks to the sustainability of public finances.

Ireland's national reform programme 2005-2008 identified its key priorities as follows: maintain a stable macroeconomic environment, sustainable public finances, and moderate inflation levels; within this fiscal framework, continue to prioritise public investment in economic and social infrastructure and other growth-enhancing expenditures; ensure that the economy will be in a position to meet anticipated long-run fiscal pressures, including those arising from the ageing of the population. The Commission's assessment was that Ireland had been making very good progress in implementing its national reform programme over the 2005-2007 period. Against the background of strengths and weaknesses identified and the evidence on progress made, the Commission encouraged Ireland to focus on the areas of: pension reform; labour market participation; R&D investment; and the careful monitoring of developments in the housing market.

The budgetary strategy in the programme is broadly consistent with the country-specific broad economic policy guidelines included in the integrated guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy. As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data. In the area of the quality of the public finances, the most noteworthy development is the maintenance of a high and rising profile of public investment over the programme period despite the deterioration in the fiscal position generally. The presentation of a single 'unified budget' is clearly an important institutional development in the evolution towards a transparent and coherent budgetary process and adds to a number of innovations in recent years, such as multi-annual capital envelopes and the "value for money" framework.

The overall conclusion is that Ireland is facing several macroeconomic challenges in its transition to a period of lower economic growth, mainly linked to a return to more sustainable activity in the housing sector. Slowing domestic demand has been accompanied by losses in recent years in export market shares, pointing to price competitiveness challenges. The fiscal position is expected to register a noticeable deterioration in 2007-2008, from a sound surplus in 2006. While Ireland is expected to continue to register a surplus in 2007, the programme foresees that the structural position will turn into a deficit in 2008, which will increase somewhat thereafter. The risks attached to the budgetary projections are broadly neutral in 2008, but from 2009, in the absence of adequate expenditure containment, outcomes could be worse than projected. While the MTO would be broadly reached in 2008, keeping to the MTO thereafter might be possible provided that the margins foreseen in the programme as contingency provisions remain unused. Furthermore, regarding the long-term sustainability of the public finances, while the public debt is low, Ireland is at medium risk because of the projected impact of population ageing on pension expenditure. The challenge for the authorities will be to deal with macroeconomic risks, while at the same time avoiding a deterioration of the fiscal situation.

Comparison of key macro economic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	**SP Dec 2007**	**5.7**	**4.8**	**3.0**	**3.5**	**4.1**
	COM Nov 2007	5.7	4.9	3.5	3.8	n.a.
	SP Dec 2006	*5.4*	*5.3*	*4.6*	*4.1*	*n.a.*
HICP inflation (%)	**SP Dec 2007**	**2.7**	**2.8**	**2.4**	**2.0**	**1.8**
	COM Nov 2007	2.7	2.8	2.2	2.0	n.a.
	SP Dec 2006	*2.7*	*2.6*	*2.0*	*1.7*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Dec 2007**	**-0.2**	**-0.5**	**-1.3**	**-1.5**	**-0.7**
	COM Nov 2007[2]	-0.5	-0.7	-1.2	-1.3	n.a.
	SP Dec 2006	*-1.2*	*-1.6*	*-2.2*	*-2.5*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Dec 2007**	**-4.2**	**-4.4**	**-3.9**	**-3.5**	**-3.1**
	COM Nov 2007	-4.0	-4.5	-4.3	-4.2	n.a.
	SP Dec 2006	*-3.4*	*-4.3*	*-4.0*	*-3.5*	*n.a.*
General government balance (% of GDP)	**SP Dec 2007**	**2.9**	**0.5**	**-0.9**	**-1.1**	**-1.0**
	COM Nov 2007	2.9	0.9	-0.2	-0.6	n.a.
	SP Dec 2006	*2.3*	*1.2*	*0.9*	*0.6*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2007**	**3.9**	**1.4**	**0.0**	**-0.1**	**0.0**
	COM Nov 2007	3.9	1.8	0.7	0.4	n.a.
	SP Dec 2006	*3.3*	*2.3*	*1.8*	*1.6*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Dec 2007**	**3.0**	**0.7**	**-0.4**	**-0.5**	**-0.7**
	COM Nov 2007	3.1	1.2	0.3	0.0	n.a.
	SP Dec 2006	*2.8*	*1.8*	*1.8*	*1.6*	*n.a.*
Structural balance[3] (% of GDP)	**SP Dec 2007**	**2.9**	**0.5**	**-0.4**	**-0.5**	**-0.7**
	COM Nov 2007	3.1	1.2	0.3	0.0	n.a.
	SP Dec 2006	*2.7*	*1.8*	*1.8*	*1.6*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2007**	**25.1**	**25.1**	**25.9**	**27.6**	**28.7**
	COM Nov 2007	25.1	25.2	26.9	28.5	n.a.
	SP Dec 2006	*25.1*	*23.0*	*22.4*	*21.9*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 5.9%, 5.2%, 4.1% and 3.8% respectively in the period 2006-2009.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2006 and 0.2% in 2007 (all surplus-increasing) according to the most recent programme and 0.0% of GDP in 2006 and 0.0% in 2007 in the Commission services' autumn forecast. According to information presented by the national authorities, they represent the impact of (i) additional revenue secured through special investigations by the tax authorities, and (ii) the payment of an exit tax associated with special savings accounts (SSIAs). These one-offs were excluded in the autumn forecast in the absence of detailed information. No information on one-offs in the period 2008-2010 is provided in the programme.

Source :

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM) which were completed on a pre-budget basis; Commission services' calculations (based on pre-budget estimates)

1. INTRODUCTION

The 2007 update of the Irish stability programme, covering the period from 2007 up to 2010, was published and submitted to the Commission and the Council on 5 December 2007. On the same date, the programme was presented together with the budget for 2008 to the Dáil (Irish lower house of Parliament).[1] There is no explicit parliamentary examination of the programme but the programme notes that 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.

This assessment is structured as follows. Section 2 discusses key challenges for public finances in Ireland, with a particular focus on strategic options for the long-term sustainability of public pension spending. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts and currently available information. Section 4 analyses budgetary implementation in the year 2007 and the medium-term budgetary strategy outlined in the new programme. Taking into account risks attached to the budgetary targets, it also assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses the quality of public finances and structural reforms, while Section 7 analyses the consistency of the budgetary strategy outlined in the programme with the national reform programme and its implementation reports and with the broad economic policy guidelines. The annexes provide a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme (Annex 1) and selected key indicators of past economic performance (Annex 2).

2. KEY POLICY CHALLENGES: POPULATION AGEING AND THE PUBLIC FINANCES – STRATEGIES FOR IMPROVING SUSTAINABILITY

This section contains an analysis of the issues surrounding population ageing and the public finances and, in particular, the identification of appropriate strategies for improving sustainability of the public finances. The topic was chosen because of the relatively large size of the projected increase in pension expenditure in Ireland in the period to 2050, and the need for measures to address the financing gap which this implies. Recently revised projections by the national authorities, while confirming the broad picture, tends to worsen sustainability concerns, as do a number of commitments in the new programme for government, although the recent publication of a Green Paper on Pensions provides an opportunity for a coherent and comprehensive framework for reform. This section briefly reviews the background and the main quantitative estimates of the impact of population ageing on public pension spending, before turning to the broad strategies available to address the issues. A final section presents some concluding remarks.

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[1] The code of conduct explicitly allows Ireland to present its programme to the Commission beyond the 1 December standard deadline, given that the budget (including the updated stability programme) is traditionally presented to the Dáil on the first Wednesday of December. The programme is included as part of the published budget documentation, which can be downloaded from www.budget.gov.ie.

2.1. Background

The Irish pension system has two main components. The first is the social welfare system, which provides basic pension benefits to persons aged 65 and over according to either social insurance principles (entitlement based on contributions linked to paid work) or to social assistance principles (based on an individual assessment of need). The second is a system of voluntary supplementary pensions, which are occupationally based or privately arranged, regulated by the state and supported by tax concessions. According to the national authorities, the overall objective of the pension system is *"to provide an adequate basic standard of living through direct State supports and to encourage people to make supplementary pension provision so that they may have an adequate income in retirement"*.[2] The basic structure of the system has been adapted considerably in recent years to improve the adequacy of benefits, to improve sustainability in the light of future demographic changes, and to modernise the system to take account of labour market changes, especially for women.

Population ageing in Ireland, as in other EU countries, will significantly increase public spending on pensions, health and long-term care. Nonetheless, it may not be immediately apparent why financial sustainability is an issue for Ireland. For instance, Ireland's relatively low level of public debt and tax burden leaves fiscal space for the future. The national authorities have undertaken specific measures to improve long-term sustainability such as the establishment of the National Pensions Reserve Fund (NPRF) and an increase in the retirement age of public servants. Furthermore, Ireland also has the lowest share of GDP in public pension spending in the EU, reflecting both its younger demographic profile and flat-rate benefit structure and by 2050, the level of spending will have risen to no more than current EU levels.

However, despite these benign features, there is little ground for complacency:

- **Revised projections:** new projections by the national authorities have revised upwards compared with the EPC projections the future expected size of the older population because of higher life expectancy and increases in the working age population reaching retirement age;
- **Limited progress on reform measures:** with the exception of the measures mentioned above, there is little evidence of recent progress in introducing measures to improve sustainability. The recently published Green Paper on Pensions presents an overview of pension issues and population ageing but, given a lengthy consultation period, specific reform measures are not expected before the end of 2008 at least;
- **New government commitments on benefit and social insurance contribution rates:** Despite the delay in setting out a comprehensive programme of reform, the national authorities have committed to significantly increase first pillar benefit rates and reduce social insurance contribution rates over the next five years; both measures will, ceteris paribus, worsen sustainability compared with the EPC projections.

In line with the risk categorisation approach adopted by the Commission, Ireland is classified as being at medium risk with regard to the sustainability of the public finances. In its opinion on the December 2006 stability programme update[3] the Council stated that: *"The initial*

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[2] Department of Social and Family Affairs (DSFA) (2007), *Green Paper on Pensions,* Dublin, Stationery Office.

[3] Council opinion on the updated stability programme of Ireland, 2006-2009, Mar. 27, 2007 O.J. C 070 (2007).

budgetary position (..) contributes significantly to easing the projected long-term budgetary impact of ageing populations, but is not sufficient to fully cover the substantial increase in expenditure due to the ageing of the population. Maintaining high primary surpluses over the medium term and implementing measures aimed at curbing the significant increase in age-related expenditures would(..) contribute to reducing risks to the sustainability of public finances". The Council concluded with an invitation to Ireland to: *"... continue to implement measures to improve the long-term sustainability of its public finances and to avoid pro-cyclical policies in the years ahead".*

2.2. Population ageing and the public finances in Ireland

Table 1 shows that pension spending amounted to 4.7% of GDP in 2004. In the projections of the EU Economic Policy Committee's Ageing Working Group (AWG-EPC), it is expected to rise to 11.1% by 2050. By contrast, social insurance contributions attributable to the pension system[4] were equivalent to 3.6% of GDP in 2005, reflecting the relatively low level of social contributions in Ireland. The "financing gap" between pension spending and contributions, currently funded from general taxation equivalent to around 1% of GDP, will increase to 3.1% by 2020, and to 7.7% by 2050.

Table 1: Projected pension spending and social insurance contributions 2004 to 2050

	2004	**2010**	**2020**	**2030**	**2040**	**2050**	**Change 2004-2050**
Gross Public Pension Expenditure (% of GDP)	4.7	5.2	6.5	7.9	9.3	11.1	6.4
Social insurance pension contributions (% of GDP)	3.6	3.4	3.4	3.4	3.4	3.4	-0.2
Financing gap (% of GDP)	1.1	1.8	3.1	4.5	5.9	7.7	6.6

<u>Source</u> :
European Commission (2006). The impact of ageing on public expenditure: projections for the EU-25 on pensions, health-care, long-term care, education and employment (2004-2050) European Economy 1/2006

Despite the Pay-As-You-Go (PAYG) nature of the pension system, some pre-funding has been introduced in recent years. Reflecting the extension of social insurance coverage to new groups and buoyant employment growth, the social insurance system has built up a small surplus since the late 1990s. However, contributions have been successively lowered to reduce labour costs and the accumulated surplus of the Social Insurance Fund (SIF) was less than 2% of GDP in 2006 and clearly inadequate to meet future pension liabilities. In 1999, the government established a National Pensions Reserve Fund (NPRF) into which 1% of GNP (about 0.8% of GDP) is placed annually from general taxation. According to legislation, the fund may be drawn down from 2025 onwards to meet future pension liabilities. According to

[4] Social insurance contributions provide eligibility for a range of payment types including unemployment and illness payments.

the December 2006 programme update, the value of the NPRF now currently stands at around 11% of GDP. However, despite the planned impressive rise in the value of the reserve fund, it should be regarded as only partially pre-funding future pension commitments.

Recent publications by the national authorities[5] suggest that the effects of population ageing may in fact be somewhat greater than previously estimated. These projected a decline in the Pensioner Support Ratio[6] (PSR) from 6 in 2006 to 2 in 2050. This is somewhat worse than the scenario contained in the AWG-EPC projections and the level of spending on public pensions projected for 2050 is 2 percentage points of GDP higher than the AWG-EPC projections (13% of GDP against 11%). The Green Paper notes a "mismatch" between spending demands and the ability to meet them, notwithstanding the existence of the National Pensions Reserve Fund and concludes that the existing system is not sustainable without adjustments to the overall policy mix. Furthermore, it notes that to safeguard the pension system in the future, a combination of measures aimed at financing and reducing the size of the projected funding gap will be required.

Despite this, recent policy commitments in relation to benefit and contribution rates are likely to worsen the overall sustainability position compared with the EPC projections. The recently published programme for government announced substantial increases in pension benefit level in the next five years.[7] Furthermore the programme also contains a commitment to reduce social insurance contributions (by a net amount equivalent in 2007 to 0.3% of GDP) and replace it with tax revenue.[8]

2.3. Strategies for improving sustainability

The national authorities are in effect faced with a double challenge, that is, to make progress on the national objectives of improving coverage and adequacy of the pension system, while at the same time credibly addressing the demographic effects of population ageing to ensure sustainability. In practical terms, this means a combination of policy reforms that reduce future spending commitments and secures enough resources to meet future pension commitments.

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[5] Department of Social and Family Affairs (2007a) *Green Paper on Pensions* , Dublin, Stationery Office and Department of Social and Family Affairs (2007b) *Actuarial Review of the Social Insurance Fund as at 31st December 2005*, Dublin, Stationery Office.

[6] Ratio of working age population to persons aged 65 plus in Department of Social and Family Affairs (2007a) op. cit.

[7] A new government took office in June 2007. Its programme included the following commitment: *"increase the basic State pension by around 50% to at least €300 per week by 2012"* (Programme for Government, 2007). From estimates contained in the Department of Social and Family Affairs (2007b) op.cit., the cost of this new higher benchmark for pension rates is expected to rise over time from 0.4% of GNP in 2016 (when fully phased in) to 1.3% of GNP from 2051 onward.

[8] The Programme for Government (2007) says that "we will abolish the PRSI (pay-related-social-insurance), ceiling for full rate payers and reduce the rate at which this tax is levied from 4% to 2% over the lifetime of the next administration. We will also reduce the rate of PRSI paid by the self employed to 2% from 3%. … The SIF will be reimbursed by the Exchequer for the cost of this reform". The estimated cost is taken from a response to Parliamentary Question 25 April 2007 (Dáil Eireann Debates (2007) Response by Minister for Social and Family Affairs to question on social insurance, Cols 927-928).

Figure 1 illustrates the alternative approaches to meeting this challenge. The top of the 'decision tree' starts with identifying the scale of the future financing gap, updated for anticipated demographic and benefit rate developments, and considering the two broad approaches to filling it namely: containing the rise in pension spending and increasing resources. Assuming that the system will continue to incorporate a high level of solidarity, thereby limiting the extent to which first pillar pensions can be adjusted to contain costs, the second approach requires a choice between pre-funding (i.e. raising taxes and/or social contributions and placing them in a fund until they are required), and pure PAYG funding which aims to increase revenue as it is required. In both cases, the resources can be found either through redirecting financial resources from other spending programmes or by increasing taxation/social insurance contributions. These alternative approaches are considered in greater detail below.

2.3.1. Pension and retirement age

The announcement in 2004 of an increase in the minimum retirement age from 60 to 65 for new public servants is expected to have a substantial impact on future pension spending. Should the age for entitlement to social insurance pensions also be raised to reflect increasing life expectancy? The nominal pension age is already relatively high (66 years, with a transitional pension for those aged 65 and retiring from employment). This is also reflected in the effective age of retirement, which was 64.1 in 2005 as against 60.7 years in the euro area. The recent Green Paper on Pensions estimated that a gradual increase in the social welfare pension age to 70 years could yield savings of 1.3% of GDP by 2056.[9] While this could go some way to closing the financing gap, it is not clear at this stage the extent to which this approach might be taken. However, it is important that the possibility of raising the retirement age be kept under review. Furthermore, if measures are being considered to raise the effective retirement age, it is important that any such reforms are based on sound actuarial calculations and that the balance of costs and benefits be taken into consideration so as to avoid an increase in total pension liabilities.

2.3.2. Review method of indexation of benefit levels

Some EU countries have reformed the way in which pensions, once granted, are indexed over time with a view to enhancing sustainability. Mixed indexation systems (related partly to earnings and partly to prices) appear to have improved sustainability, while at the same time protecting the real value of benefits and ensuring that pensions do not fall too far behind earnings.[10] Ireland has currently no formal system of indexation, but in recent years, benefits have risen faster than earnings. Clearly, the extent to which this can take place in the future is linked with views on the adequacy of benefit levels. Given that adequacy improvements have been a cornerstone of increasing pension benefit rates in recent years, it might take some time before this approach could become feasible.

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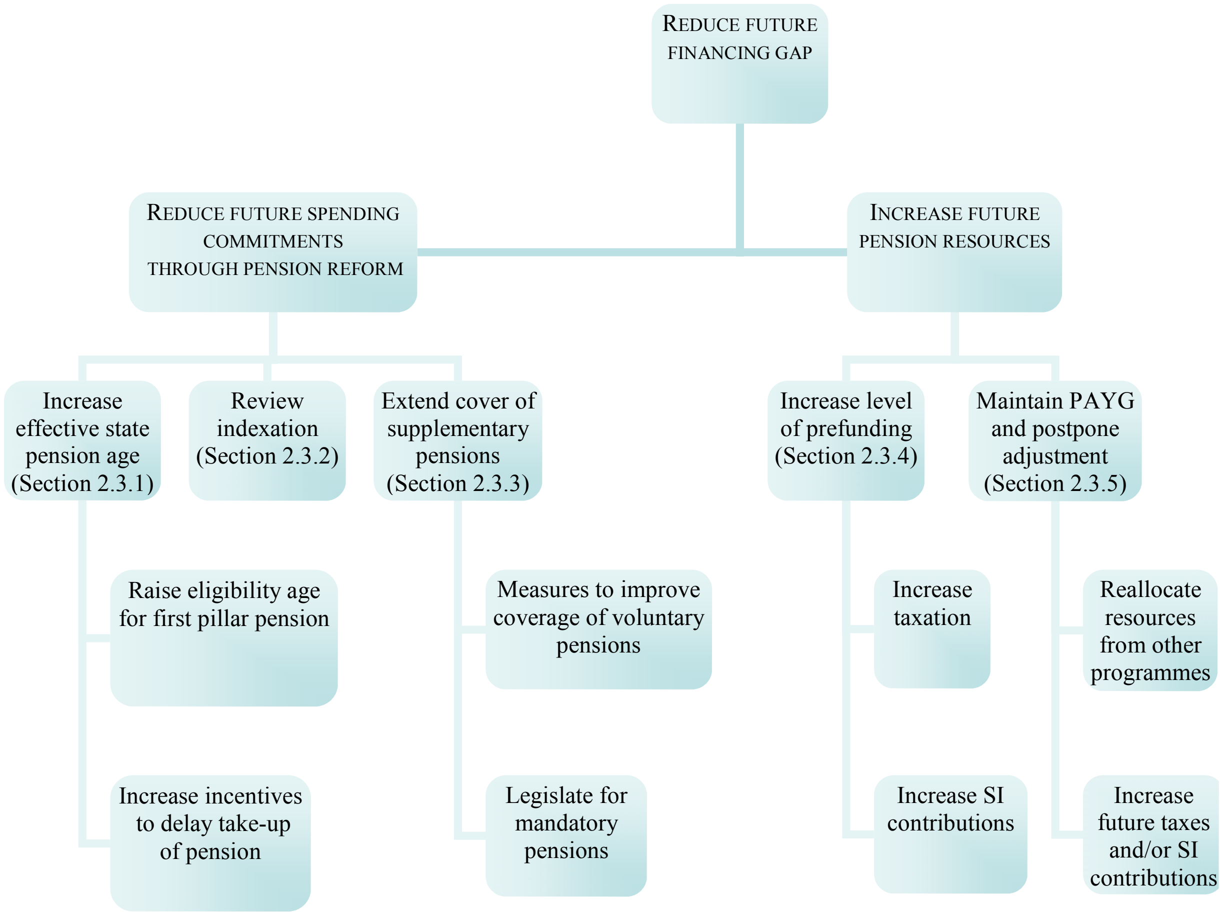
[9] Department of Social and Family Affairs (2007a) op. cit.

[10] OECD (2007), *Pensions at a Glance: Public policies across OECD countries.*

Figure 1: Potential pathways to sustainability



2.3.3. Extending supplementary pensions

Ireland does not have a mandatory supplementary pillar payment system but relies instead on voluntary arrangements. Supplementary pensions play a significant role and the indicative[11] target for supplementary pension coverage is 70% of the workforce who are over 30 years of age. Currently, 62% of workers have such cover[12] but a problem of inadequate coverage persists.[13] In addressing this, the national authorities are faced with a choice of continuing with the existing voluntary approach or moving towards mandatory supplementary pension coverage.

Improve take-up of voluntary supplementary pensions: Besides providing an effective regulatory oversight of pension funds, the traditional policy instrument in this area is the provision of favourable tax arrangements. The cost of these, in the form of foregone tax revenue, was estimated at 1.7% of GDP in 2006 with much of the benefit going to high-

[11] The second annual progress report of the Irish authorities on the Lisbon Agenda said that "this target has not been accepted as a definite Government target though it has informed work in this area". Department of the Taoiseach 2007.

[12] Department of Social and Family Affairs (2007a), op. cit.

[13] Pensions Board (2005), *National Pensions Review,* Dublin.

income earners.[14] Therefore, reform could target tax relief more efficiently at low-income earners and thereby increase coverage without increasing overall cost.

Mandatory supplementary pensions: Some consider that targets will not be met without some change to the current system.[15] A number of approaches to introducing mandatory supplementary pensions have been identified. These approaches would have significant negative implications for the public finances through the introduction of a direct exchequer contribution to a mandatory scheme fund or an increased cost because of a higher level of tax foregone in support of such arrangements. Another approach being considered is a "soft-mandatory" scheme whereby workers are obliged to join the scheme but have a right to opt-out if they wish.

2.3.4. Increase pension pre-funding

The establishment of the NPRF and, to a far lesser extent, the maintenance of a surplus on the SIF have introduced partial pre-funding into the mainly PAYG Irish pension system. The government could seek to reduce the financing gap through increasing the extent of pre-funding. (Section 5 of this assessment provides an up-to-date assessment of the size of the adjustment required.) A given increase would lead to a permanent improvement of the primary balance thereby improving long-term sustainability and proportionally reducing the sustainability indicators identified in section 5 and table 11 of this assessment. (for instance, an increased contribution of 0.1% of GDP would reduce the S2[16] indicator by 0.1% of GDP). In principle, the national authorities could choose to finance an increased contribution through either an increase in taxation or a rise in social contributions. The authorities could decide to use either the NPRF or the SIF as a vehicle for pre-funding, although this is a secondary issue.

A key issue for the national authorities is whether to pre-fund pensions using higher taxation, increased social insurance contributions or a combination. In the past, the authorities have implicitly favoured tax-financed pre-funding over the social insurance fund and a continuation of this approach has been signalled by the commitment to reduce social insurance contributions further and replace them with tax revenue. It is the overall level of pre-funding of future pension liabilities that is decisive and not simply the value of the NPRF, which has tended to be emphasised by the national authorities. Over the period 1994-2004, the cumulative impact of changes to the social insurance system had been to reduce contribution revenues by an annual amount equivalent to 0.8% of GDP[17] implying that the annual contribution to the NPRF have been considerably offset by a reduced surplus on the

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[14] Department of Social and Family Affairs (2007a), op. cit.

[15] Pensions Board (2005), op. cit.

[16] The S2 indicator provides a quantitative measure of the extent to which long-term costs of ageing are addressed in current budgetary policies. It takes into account the initial budgetary position and the long-term changes in the primary balance associated with ageing. Further details are provided in Section 5.

[17] Calculated from Department of Social and Family Affairs (2005), PRSI issues. Unpublished paper to the Tax Strategy Group. http://www.finance.gov.ie/viewdoc.asp?fn=/documents/tsg/2005/TSG_04_16prsi.rtf

SIF. On the basis of the recent actuarial review, this SIF surplus is projected to disappear in a relatively short period of time in the face of higher benefit expenditure.[18]

The choice of whether to increase the level of pension pre-funding through general taxation or through social insurance contribution rates should consider the impact on employment and growth. Being more broadly based, the negative impact for economic growth of using tax revenue is generally considered to be smaller than that of using social insurance contributions. However, an increased financing of pensions from general taxation implies an arbitrary transfer from general taxpayers to social insurance pensioners. It may therefore be useful in the future to use a combination of both approaches to increase the level of pre-funding.

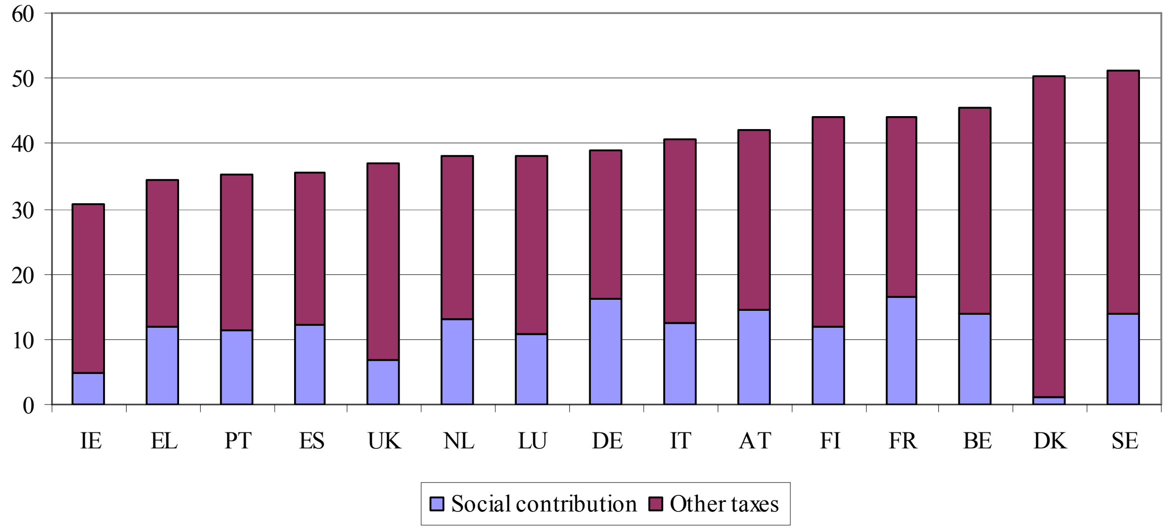
2.3.5. Maintaining a pure PAYG approach and postponing adjustment

As the increase in pension spending will not arise for a number of years, the national authorities theoretically have the option of waiting and addressing future increases in spending through increasing revenue or through diverting spending from other programmes at the time the need arises. Figure 2 shows that total taxes and social contributions as a share of GDP are considerably lower than elsewhere, theoretically suggesting that there is scope to increase them in the future to meet pension liabilities. An alternative approach might be to switch spending from other spending programmes into pensions. For instance, Ireland is expected to spend about 4¼ % of GDP per year on capital investment in the medium term, partly to catch up with levels of infrastructure elsewhere in other developed countries. Completion of infrastructural programmes will wind down from this high level as the infrastructural programme matures. If Ireland were to reduce spending on public capital to the EU-25 average, this would free up around 1-1½% of GDP to meet the increase in pension spending. However, even if it were possible to reduce this in the future as Ireland's infrastructure levels converge with those in other countries in the EU, this would not be enough to meet the financing gap without significant other measures.

Furthermore, there are considerable risks with relying too much on future adjustment rather than taking action at an earlier stage. Delay means that the cost of adjustment will be significantly greater as it will have a shorter time to take effect, thus increasing also considerably the uncertainty as to the final level of the pension benefit. In the future, labour may be even more mobile than at present, thereby making it more difficult to increase social insurance contributions without an impact on growth. Finally, and above all, it is clear that financial adjustment to population ageing must be perceived as being equitable between generations: if measures are delayed, the perception that the cost of ageing will be increasingly borne by cohorts entering the labour force in future years will grow and undermine the PAYG nature of the pension system.

[18] Department of Social and Family Affairs (2007). *Actuarial Review of the Social Insurance Fund as at 31st December 2005,* Dublin, Stationery Office.

Figure 2: Social contributions and taxes as % of GDP (2005)



Source: European Commission (2007). Taxation trends in the EU.
(http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_structures/index_en.htm).

2.4. Concluding remarks

The need to implement additional measures to address the budgetary impact of an ageing population has been identified for Ireland and endorsed by the Council. Measures taken to date, most notably the establishment of the NPRF, will make a positive contribution but further measures are necessary. This is accepted by the national authorities, whose recent Green Paper on Pensions concluded that the existing system is not sustainable without adjustments to the overall policy mix and that a combination of measures aimed at financing and reducing the size of the projected funding gap will be required. Assuming that the system will continue to incorporate a high degree of solidarity between generations and given the relatively low level of pension spending currently, the scope for relying purely on measures to control spending is limited. In effect, measures on both the spending and the revenue sides will be required.

Measures to reform the pension system, such as an increase in the retirement age and a revision to the method of indexation of benefits, could have a positive impact on long-term sustainability. Greater take-up of voluntary pensions could also be pursued, either through reform of incentives or by considering whether or not they should be made mandatory. On the financing side, a desire to increase the level of resources available to the pension system in the future means that it is necessary to increase pre-funding, either through higher taxation or social insurance contribution rates or diverting financial resources from other uses. The need to avoid too great an impact on growth and employment suggests that the financing gap should not be made up entirely by higher contribution rates. Furthermore, the government may decide not to address the entire financing gap through pre-funding and increase resources in the future at the time the need arises. For instance, a winding down of public investment after the current programme of infrastructural development has been completed could meet some of the financing gap. However, a protracted delay in implementing reform measures risks missing the current favourable demographic, economic and employment circumstances.

3. MACROECONOMIC OUTLOOK

This section assesses the plausibility of the macroeconomic scenario (economic activity, labour market, costs and prices) underpinning the public finance projections of the programme. It also examines whether good or bad economic times in the sense of the Stability and Growth Pact prevail. Finally, it describes macroeconomic vulnerabilities and how they are expected to develop according to the programme.

3.1. Economic activity

Economic developments in 2007 marked something of a turning point for the Irish economy. Real GDP growth is expected to have slowed down more markedly than previously anticipated, with the updated programme estimating growth at 4.8%, compared with 5.3% in the previous programme and 4.9% in the Commission services' autumn 2007 forecast.

The slowdown, particularly in the latter part of the year, signalled the likely passing of a period dominated by very strong domestic demand growth, led principally by booming activity in the housing market. This recent period of rapid expansion of domestic demand, which extended back to the early part of the decade, had followed the "Celtic-tiger" period of even faster real GDP growth in the latter half of the 1990s, when strong export growth played a critical role. Nonetheless, despite the shift toward domestic demand, growth rates in the more recent period were still very impressive, allowing Ireland to overtake most EU Member States in terms of per capita income levels. By 2006, GDP per capita in Ireland was the second highest in the EU (147% of EU average), surpassed only by Luxembourg.

The ingredients behind the stellar economic performance of the Irish economy are by now well documented, namely a fast-growing and well-educated young workforce, a business-friendly policy environment, a strong social partnership providing industrial stability and wage restraint, as well as overall macroeconomic stability and a generally supportive role played by the public finances. These ingredients had been built up particularly since the late 1980s and have been key in supporting a fast growing economy. Successive Irish stability programmes have anchored macroeconomic and fiscal policies within the broad framework of the Stability and Growth Pact.

The performance of the economy in 2007 compares fairly well with the previous period of sustained growth (2002-2006), when GDP growth averaged 5.4%. However, it is likely that much of the growth in 2007 was concentrated in the first half of the year and that the latter half witnessed a transition to a period of below potential growth in the short- and medium-term. The programme notes that GDP is estimated to have risen by 6.7% year-on-year in the first half of the year and that the annual growth estimate is consistent with a sharp slowdown in the latter half of the year, reflecting in particular the impact of a rapidly cooling residential construction sector. Data released since the publication of the programme confirm this view, with GDP estimated to have grown by 4.1% year-on-year in the third quarter. For 2008, real GDP growth is projected at 3.0% compared with 3.5% in the Commission services' autumn forecast, before a modest acceleration to 3.5% in 2009 (3.8% in the autumn forecast) and 4.1% in 2010 (Table 2).

As in most of the period since 2003, economic activity in 2007 was largely driven by domestic demand. Private consumption is estimated by the programme and the Commission services' autumn forecast to have grown by 6.6% in 2007 reflecting continued growth in employment and disposable income, as well as the maturation of the bulk of Special Savings Investment Accounts (SSIAs).[19] The growth rate of gross fixed capital formation is expected to be 1.5% in 2007. This represents a sharp deceleration from previous years due entirely to the fact that the residential building boom has receded rapidly from its 2006 peak of almost 90,000 dwelling units per year. While the outcome in 2007 in residential construction was expected to have been still above the estimated long-term sustainable level (60,000 to 70,000 units), its fall implies a large drag on total investment. The other components of fixed investment, are expected to have grown rapidly. This is particularly the case with the increase in machinery and non-residential investment (the magnitude and timing of which are heavily determined by imports of aircraft) and by the large increase in public capital spending. The programme's estimate of growth in the former is higher than in the autumn forecast and largely explains the difference between the programme and autumn forecast estimates for gross fixed capital formation in 2007, although the programme estimate for the negative impact of stock-building on growth is slightly lower than in the autumn forecast (0.4 pp. vs. 0.6 pp.).

Table 2: Comparison of macroeconomic developments and forecasts

	2007		2008		2009		2010
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	4.9	4.8	3.5	3.0	3.8	3.5	4.1
Private consumption (% change)	6.6	6.6	3.4	3.8	3.7	3.9	4.0
Gross fixed capital formation (% change)	0.6	1.5	-0.5	-1.6	2.6	2.3	3.1
Exports of goods and services (% change)	7.0	6.8	5.8	5.6	6.2	5.2	5.0
Imports of goods and services (% change)	6.0	5.9	4.7	4.5	5.9	4.3	4.1
Contributions to real GDP growth:							
- Final domestic demand	4.0	4.0	2.1	1.9	2.8	2.7	3.0
- Change in inventories	-0.6	-0.4	0.0	-0.1	0.0	-0.2	0.0
- Net exports	1.4	1.3	1.4	1.3	0.9	1.1	1.2
Output gap[1]	-0.7	-0.5	-1.2	-1.3	-1.3	-1.5	-0.7
Employment (% change)	3.3	3.5	1.3	1.1	1.5	1.3	1.5
Unemployment rate (%)	4.5	4.6	5.3	5.6	5.5	5.6	5.5
Labour productivity (% change)	1.5	1.2	2.2	1.8	2.3	2.2	2.5
HICP inflation (%)	2.8	2.8	2.2	2.4	2.0	2.0	1.8
GDP deflator (% change)	2.1	2.7	2.2	2.5	2.2	2.3	2.1
Comp. of employees (per head, % change)	5.2	n.a.	4.0	n.a.	4.0	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-4.5	-4.4	-4.3	-3.9	-4.2	-3.5	-3.1

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source :

Commission services' autumn 2007 economic forecasts (COM); Stability programme (SP)

[19]The SSIA scheme was announced in 2001 by the Minister for Finance with the aim of encouraging private savings. For approved accounts, monthly amounts of up to €254 were "topped up" by a 25% exchequer bonus provided that savings were left untouched for five year. The scheme proved far more popular than originally envisaged by the authorities and at its peak just before the maturation of the scheme in 2006/7, it is estimated accrued savings in SSIA's (net of exit tax) amounted to €16 billion or 8.5% of GDP in 2007, Source: *Commission services, Department of Finance*.

Public consumption is also expected to have grown strongly (4.8%) in 2007 reflecting rapid growth in public spending. The programme estimates a strong increase in exports (6.8%), - only slightly less than in the Commission services' autumn forecast, - particularly in the chemicals and information technology sectors as well as in services, compared with a projected increase of 4.9% in the previous programme. Therefore, despite an associated increase in imports (5.9%), net exports' contribution to growth is expected to have been 1.3 pp. of GDP, representing its largest contribution since 2003.

Turning to the outlook in the short-term, 2008 is expected to experience the full impact of the decline in residential construction, leading to a projected decline in fixed investment of 1.6%. With housing construction expected to be about two-thirds of its 2006 peak, significant increases in commercial and public investment as well as investment in machinery underpin the investment forecast. Private consumption growth is expected to remain fairly robust (3.8%), but to a considerably less extent than in previous years, particularly as the pace of employment growth slows and the impact of the special savings scheme disappears. Public consumption will grow at a similar rate (3.6%). Net exports are expected to repeat their positive contribution giving an overall programme expectation of GDP growth of 3.0%. The programme also envisages a fall in the external deficit at a somewhat faster rate than the autumn forecast, which may be explained by the lower growth rate. Over the remainder of the programme period, as the impact of falling residential construction output wanes, the overall level of economic activity is expected to recover somewhat, with domestic demand returning to higher levels and net exports making a lower though still significantly positive contribution, very much in line with the developments expected in the autumn forecast.

Regarding the last year of the programme period (2010), which is not covered by the Commission services' autumn forecast, the increase in real GDP projected in the programme is only slightly lower than the Commission services' estimate of potential output growth for 2007-2009 (4.1% against 4.3%). Furthermore, the projected widening of the output gap over the 2007-2009 period is also in line with the trend projected in the autumn forecast. Projections of the size of the negative output gap are only slightly larger in the programme than in the autumn forecast, with the difference less than ¼ pp. in 2009. However, a comparison with the previous programme shows a significant degree of instability of output gap estimates, which underlines the uncertainty surrounding such estimates. In addition, evaluations of potential output and output gaps for Ireland are subject to considerable uncertainty, because of the difficulty of obtaining reliable estimates of potential growth after the extraordinary growth performance in recent years, structural changes over the last decades and openness of the labour market.

Overall, the programme's macroeconomic scenario appears to be based on plausible macroeconomic assumptions. The programme's growth projections are broadly in line with the Commission services' autumn 2007 forecast.[20] The stability programme projects slightly lower GDP growth for 2008 (3% vs. 3.5%) and 2009 (3.5% vs. 3.8%). The general deterioration in sentiment since the publication of the autumn forecast suggest that the risks are more negatively tilted, implying that the programme projections may be more plausible

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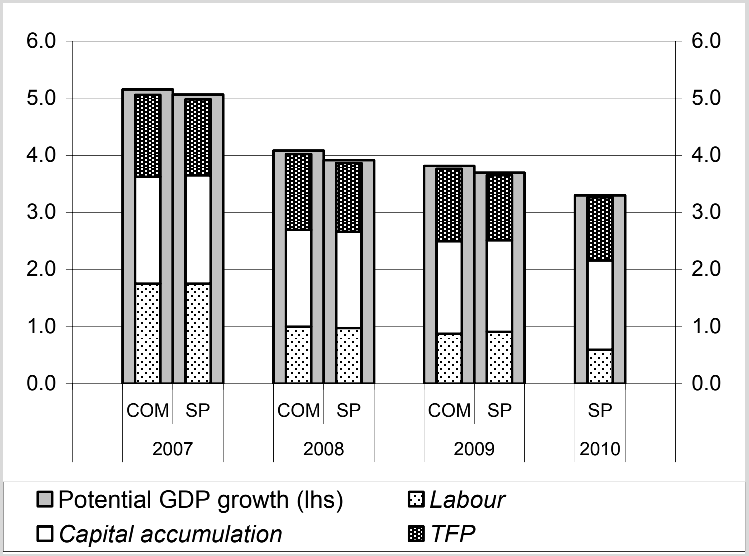
[20] The external outlook behind the programme's macroeconomic scenario is in line with that in the Commission services' autumn 2007 forecast.

than the autumn forecast when viewed alongside more recent information. Specifically, the 2008 projection is largely explained by a more pessimistic forecast of house completions, which stabilises earlier and at a lower level than the Commission services' forecast. Developments in other growth components reflect minor differences.

Box 1: Potential growth and its determinants

The graph below presents estimates of potential output that is consistent with the programme's macroeconomic scenario, according to the Commission services' recalculations using the commonly agreed methodology based on the information provided in the programme. The results are very similar to those presented in the Commission services' autumn 2007 forecast and the same holds for the relative growth contributions from individual components (labour, capital accumulation and total factor productivity (TFP)).

Potential growth and its determinants



Compared to average growth in the past ten years presented in the table in Annex 2, Ireland's GDP growth rate is gradually decreasing along with its potential. The decline of potential output growth comes mostly from lower productivity growth. The average estimated TFP contribution to potential growth has declined from 3.9% (1996 – 2000) to 1.3% (2007-2010). Ireland's productivity growth in the late 1990s was driven by a continued strong productivity performance in high-technology manufacturing industries (i.e. chemicals, electronics and printing/publishing) and an improvement in the productivity performance of the construction and tradable services (i.e. communications, software, and financial services) sectors. The fall in productivity growth in recent years may in part reflect cyclical trends, given that strong growth in employment (largely through immigration) is often associated with weaker productivity growth. It may also reflect structural factors, as more people are now working in relatively low productivity growth sectors (housing construction).

In the medium term, the decrease in potential growth is characterized by a lower labour contribution, taking into account immigration projections and lower economic activity in labour intensive sectors. In contrast, the contributions from capital accumulation and TFP to potential output growth will be sustained and amount to, respectively, 1.7% and 1% on average in 2007-2010.

Nonetheless, risks have increased somewhat since the publication of the programme, especially concerning 2008. While there is a possibility of a better export performance to markets less affected by current negative sentiment (especially through further improvement in services exports) or an earlier-than-expected stabilisation of the residential construction sector, the balance of risks is probably on the downside. Firstly, developments in the U.S. and the U.K. may turn out to be worse than expected; the former holding a deeper resonance for the Irish economy than its trade share would suggest because of its importance as a source of direct investment. Second, the assumed ability of Irish exporters to take advantage of improving markets can be questioned given the deterioration in competitiveness seen in recent years, which reflects both domestic cost and exchange rate developments. The financial services sector, which is important for Ireland's current account as an exporter of financial services, could also be affected by the current turmoil in financial markets. Third, the adjustment in housing construction could have a more severe impact on the wider economy, through asset price and/or confidence effects.

3.2. Labour market and cost and price developments

The projected evolution of the labour market, in both the programme update and the autumn forecast, is consistent with a period of below-trend growth, as the economy becomes much less dependent on the employment-intensive construction sector and output shifts more to meet external demand. The programme's profiles for employment, unemployment and productivity developments are close to those in the Commission services' autumn forecast, with the somewhat higher Commission growth forecasts being reflected in higher employment growth.

More specifically, the programme projects a significant moderation in employment growth from the very high rates of increase observed in recent years, which were mainly met by high immigration. Employment growth in 2008 is expected to be one full percentage point lower than the previous programme (1.1% against 2.1%) and merely 0.2 pp. lower against the autumn forecast, as employment in construction falls in response to reduced output in housing construction. An assumed stabilisation in housing construction in 2009 allows for a partial recovery in employment although not to previously forecast rates (1.3% against 1.6%). Unemployment is expected to rise from 4.6% to 5.6% in 2008 (rising somewhat more rapidly than in the autumn forecast reflecting the slightly more pessimistic picture on employment) and remain at that level until the end of the programme. This compares with a broadly unchanged unemployment scenario over the previous programme. As with the autumn forecast, the unemployment projections appear to include assumptions about a slowing labour supply (probably reflecting mainly lower immigration), which are plausible even if difficult to forecast with any degree of certainty.

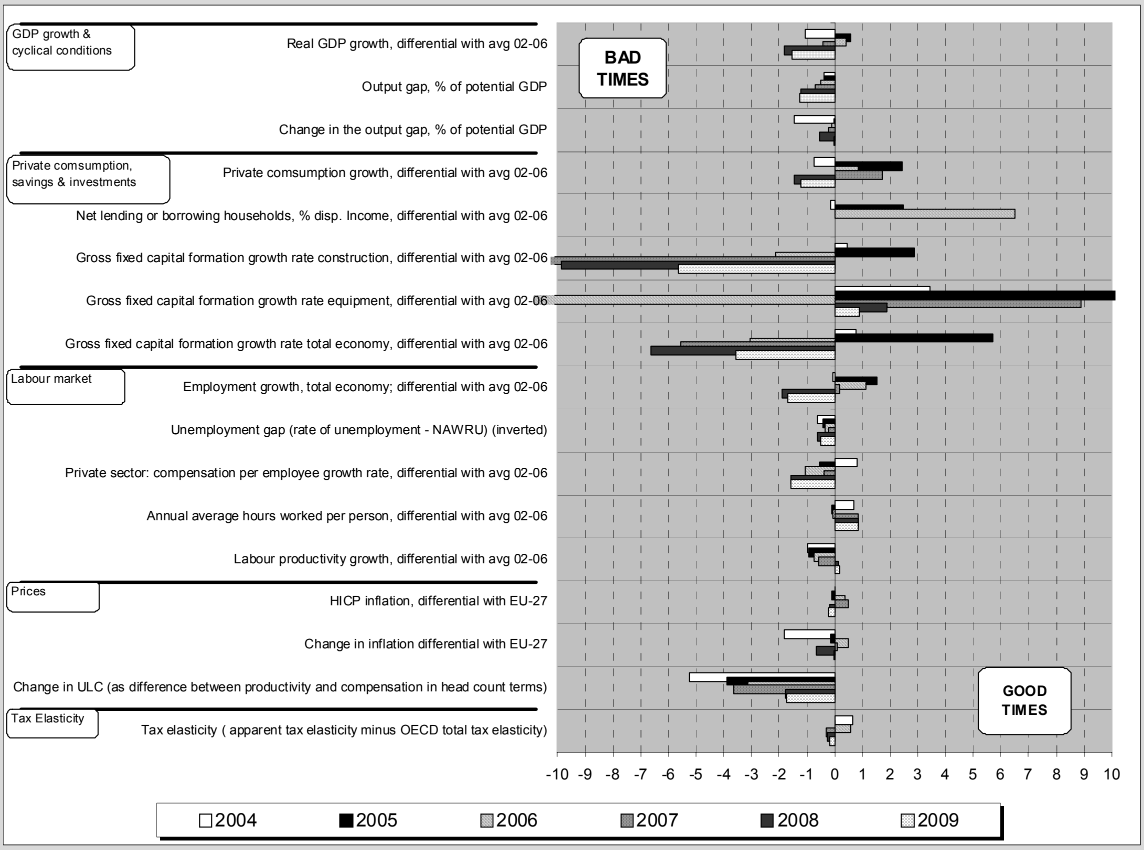
The assessment of the labour content of growth is complicated by a number of features in the forecast. A period of below-trend growth would, ceteris paribus, suggest a cyclical decline in productivity. However, this feature tends to be offset by both the rapid reduction in housing output (where the labour content of output is relatively high) and the renewed importance of the high-technology export sector (where labour content is very low, particularly in those sectors such as chemicals, where growth has been strongest). Taking these factors into account, the programme projections have shifted downwards their labour productivity assumption for 2008 before allowing it to recover in 2009 and 2010.

Box 2: Good or bad economic times?

According to the code of conduct, the assessment of whether the economy is experiencing good or bad economic times starts from the output gap, but draws on an overall economic assessment, which should also take into account tax elasticities. The figure below presents a set of macroeconomic indicators drawn from the Commission services' autumn 2007 forecast. The mixed picture in 2007 reflects the considerable differences between the first and second halves of the year and suggests an overall assessment of 'neutral times'. The economy seems to have entered economic 'bad times' in 2008 taking into account tax elasticities and remains in 'bad times' for the duration of the period 2008-2009.

However, assessment of good or bad economic times for Ireland is subject to considerable uncertainty reflecting profound structural changes in recent years and consequent difficulties in obtaining consistent estimates of potential growth. Furthermore, the interpretation of below potential projections for growth is problematic in the sense that while deepening negative output gaps and low tax elasticities in the period 2008-2009 strongly suggest 'bad times'. An alternative interpretation of these trends could be to say that Ireland is entering a period of growth normalisation (from high growth rates in the past to lower growth path in the future).

Good versus bad times



Regarding the projections for HICP inflation, both programme and commission services' autumn forecasts show projections in 2007-2009 which are in line. HICP inflation was relatively high in 2007 at 2.8%, reflecting mainly higher service sector inflation and the pick up in food and energy prices. The programme projection for inflation in 2008 is only slightly above that in the autumn forecast (0.2 pp.), as it took into account the impact of tobacco excise increases announced in the budget. There are a number of offsetting factors determining the course of inflation over the programme period. In the near-term, higher food and energy prices constitute an important source of upward pressure especially for 2008, although offset to some extent by exchange rate movements. On the basis of currently available information, it is therefore likely that the programme forecast for 2008 could be somewhat on the low side. However, in the outer years of the programme, prospects for a slowdown in inflation are supported by an improvement in labour productivity stemming from changes in the sectoral composition of output and the downward impact on wage pressures of a slowing labour market. Inflation as measured by the national CPI measure, which is important for national wage bargaining, rose from its already uncomfortably high level in 2006 of 4.0% to 4.9% in 2007, with the difference compared with the HICP essentially due to the former's inclusion of mortgage interest costs.[21] As the impact of mortgage interest increases diminish over time, both measures of inflation would be expected to converge on lower rates over the course of the programme.

3.3. Macroeconomic challenges

During the period of buoyant economic growth of the past few years, public finances improved considerably, thereby allowing an impressive reduction in the public debt ratio. The transition from the recent period (2003-2007) of high growth led by tax-rich domestic demand to a period where growth is both lower and more reliant on net exports, poses significant challenges for the Irish economy.

On the external side, a key challenge is determining the appropriate response to the larger downside risks associated with the international economy and the US in particular, but also the UK, given its importance as a destination for the more labour intensive products of the Irish export sector. This is further aggravated by the fact that Ireland's nominal effective exchange rate has appreciated considerably in recent years reflecting both domestic inflation and exchange rate movements. In this regard, a renewed focus on regaining competitiveness through the containment of both labour and non-labour costs and the raising of productivity growth would improve the ability of Irish exporters to take advantage of improved market conditions.

On the domestic front, the challenge is to cope with a rebalancing of growth. Looking beyond the projected decline in the residential sector, the underlying economic picture is expected to be rather benign but it could be threatened by a number of developments such as a deeper and longer-lasting correction in residential construction, wealth and/or confidence effects on private consumption and investment stemming from falling asset values, as well as rising unemployment. Furthermore, recent immigration rates are not sustainable as the cyclical position of the economy worsens and may have additional effects on residential construction. Hence policy makers need to focus on identifying and supporting the key drivers of growth in the future.

These macroeconomic challenges will have significant implications for the public finances, in spite of their overall strong starting position. The nominal general government balance would be expected to fall as the economic cycle turns to bad times (see Box 2). However, the prolonged experience of high and increasing surpluses in the period 2003-2006 will have generated expectations for enhanced public services, which may increase pressure to reduce the structural balance further. The challenge for the authorities will be to respond simultaneously to risks from the macroeconomy, while at the same time avoid any worsening of the fiscal situation other than that implied by automatic stabilisers. Key elements of the

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[21] The CPI excluding mortgage interest costs rose by 2.6% in 2007.

response to this challenge will involve completing the ambitious infrastructural plans as well as giving renewed attention to structural reforms which improve the overall productivity of the economy.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2007 and the second presents the medium-term budgetary strategy in the new update. The third analyses the risks attached to the budgetary targets in the programme. The final part assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

4.1. Budgetary implementation in 2007

The programme estimates a general government surplus of 0.5% of GDP for 2007. This is a significantly weaker outturn compared to a surplus of 1.2% of GDP projected in the December 2006 stability programme and 0.9% in the Commission services' autumn forecast. This is in contrast with the experience in recent years, when the programme generally under-estimated final outturns for the first year of the programme (by 0.7 pp. on average for 2003-2006). Subsequent end-year cash data for central government seem to support the new programme estimate. In particular, the under-performance of tax receipts in the final two months of the year explains the less favourable projection in the programme compared to the autumn forecast.

Table 3 compares the 2007 revenue and expenditure targets (as a percentage of GDP) from the previous update of the stability programme with the results of the new programme. The difference between the revenue and expenditure targets for 2007 and the projected outcome is decomposed into a base effect, a GDP growth effect on the denominator and a revenue / expenditure growth effect.[22]

- The base effect captures the part of the difference that is due to the actual outcome for 2006 being different from what was projected in the previous update in the programme (either because the actual revenue / expenditure level in 2006 was different from the estimated outturn in the previous programme or because GDP turned out to be different from the scenario in the previous update of the programme). The base effect therefore also captures the effect of revisions to the GDP series.
- The GDP growth effect on the denominator captures the part of the difference that is related to current GDP growth projections for 2007 turning out higher or lower than anticipated in the previous update of the programme (therefore reducing / increasing the denominator of the revenue and expenditure ratio).
- The revenue / expenditure growth effect captures the part of the difference related to the revenue / expenditure growth rate in 2007 turning out to be higher or lower than targeted in the previous update of the programme. This would typically be due to GDP developments

[22] A fourth, residual component is usually small, except if there are very large differences between the most recent update of the programme and the target (the full mathematical decomposition is in the methodological paper mentioned above).

different from those expected in the previous update of the programme, or as a result of apparent tax elasticities different from the ex ante tax elasticities (or both).

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Table 3: Budgetary implementation in 2007

	2006		2007	
	Planned	**Outcome**	**Planned**	**Outcome**
	SP Dec 2006	**SP Dec 2007**	**SP Dec 2006**	**SP Dec 2007**
Revenue (% of GDP)	36.8	37.1	36.6	36.6
Expenditure (% of GDP)	34.6	34.2	35.4	36.1
Government balance (% of GDP)	2.3	2.9	1.2	0.5
Nominal GDP growth (%)			8.1	7.6
Nominal revenue growth (%)			7.5	6.1
Nominal expenditure growth (%)			10.6	13.6
Revenue surprise compared to target (% of GDP)			**0.0**	
Of which [1] : 1. Base effect			0.3	
2. GDP growth effect on the denominator			0.2	
3. Revenue growth effect			-0.4	
Of which: due to a marginal elasticity of total revenue w.r.t. GDP larger than 1 [2]			*-0.3*	
Expenditure surprise compared to target (% of GDP)			**0.7**	
Of which [1] : 1. Base effect			-0.4	
2. GDP growth effect on the denominator			0.1	
3. Expenditure growth effect			0.9	
Government balance surprise compared to target (% of GDP)			**-0.7**	
Of which: 1. Base effect			0.7	
2. GDP growth effect on the denominator			0.0	
3. Revenue / expenditure growth effect			-1.3	

Notes:

[1]A positive base effect points to a higher-than-anticipated outcome of the revenue / expenditure ratio in 2006. A positive GDP growth effect (on the denominator) indicates lower-than-anticipated economic growth in 2007. A positive revenue / expenditure growth effect points to higher-than-anticipated revenue / expenditure growth in 2007. The three components may not add up to the total because of a residual component, which is generally small.

[2] Equal to (2)+(3). A positive sign means that the marginal elasticity of revenue with respect to GDP exceeds one.

Source :
Commission services

Table 3 shows that the outturn for the expenditure ratio is expected to be 0.7 pp. higher than in the previous programme. At first sight, this seems to explain all of the deviation in the fiscal balance outcome from the planned one. However, this is not the full picture. An assessment of the overall deterioration in the 2007 surplus should also take account of a positive base effect in 2006 of 0.7% of GDP given that the already large general government surplus in 2006 (estimated by the previous programme at 2.3% of GDP) turned out even higher, at 2.9%, reflecting both lower expenditure and higher revenue ratios. The revenue ratio is expected to finish the year in line with the 2006 target (36.6% of GDP) but a substantial shortfall against targeted nominal revenue growth, leading to a negative revenue surprise of 0.4 pp., is masked by the 2006 revenue base effect.[23] This 'surprise' reflected in

[23] The estimated outturn for the general government balance in 2007 according to the December 2007 programme includes the relatively minor impact of one-off and other temporary measures. According to the national authorities, these one-offs represent the impact of additional revenue secured through special

particular the weakening in the housing market, especially in the latter part of the year. As for expenditure, higher-than-planned spending contributed 0.9 pp. of GDP to the deterioration in the fiscal balance, with unplanned current primary spending (mainly on goods and services) and capital grants and payments (particularly for the higher education and agricultural sectors) being only partly offset by savings on interest expenditure and transfer payments. However, some of the non-programmed increases in expenditure in 2007 is likely to have represented spending that did not materialise in 2006 as originally planned.

The opinion of the Council on the previous update of the stability programme did not specifically refer to budgetary implementation in 2007 but contained the general advice that "the medium-term budgetary position is sound … Nonetheless, it would be prudent to maintain room for manoeuvre against any reversal of the current growth pattern which has been led by strong housing sector developments". The 2007 budget outturn, entailing a sizable reduction of the structural surplus, reduced the room for manoeuvre into 2008. The favourable base effect from 2006 was partly offset by expenditure overruns accompanied by the negative revenue surprise associated with the slowdown in the economy. Although the structural balance remained better than the MTO, these expenditure overruns meant that budgetary implementation in 2007 was not fully in line with the April 2007 Eurogroup orientations for budgetary policies.

4.2. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with that in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

4.2.1. The main goal of the programme's budgetary strategy

Ireland's medium-term objective (MTO) is framed in terms of a balanced position in structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures).[24] Despite a noticeable weakening of the budgetary position in 2007, the MTO is expected to have been reached with a large margin, albeit markedly smaller than planned in the previous programme. The strategy outlined in the programme implies a further marked weakening of the structural balance in 2008. Specifically, it deteriorates by almost 1 pp. in 2008, thus turning into a deficit of about ½% of GDP, and gradually worsens in subsequent years, to reach a negative ¾% of GDP in 2010. The fiscal stance as measured by the change in the primary structural balance in 2007 and 2008 is assessed as expansionary. In 2009 and 2010 the stance is neutral or mildly expansionary subject to uncertainty about cyclical economic conditions (see Section 3).

The larger structural deterioration envisaged with respect to the previous programme reflects a substantial downward revision of the targets for the headline balance throughout the programme period (see Table 4). Specifically, the 2008 budgetary target has been revised

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investigations by the tax authorities and the payment of an exit tax associated with special savings accounts (SSIAs) by an amount equivalent to 0.2% of GDP in 2007 (compared with 0.1% in 2006). These one-offs were not included in the autumn forecast in the absence of detailed information.

[24] As recalculated by the Commission services on the basis of the information in the programme according to the commonly agreed methodology.

downwards by 1.8 pp. of GDP as compared to the previous programme. Reflecting an expansionary fiscal stance, this deterioration exceeds the cumulative effect of (i) the worse-than-expected initial conditions determined by the budgetary outturn in 2007, and (ii) the impact of the downward revision in the projections for economic growth in 2008, as suggested by the standard budgetary sensitivity measure. The headline balance is planned to fall by 1.4 pp. in 2008 relative to 2007, turning into a deficit of 0.9% of GDP. In line with the previous update, the government balance is then projected to continue deteriorating by 0.2 pp. of GDP in 2009 and to improve only marginally in 2010, to minus 1% of GDP. Following a similar path, the primary surplus is projected to shrink to zero in 2008 and to remain around that level in the following years.

Table 4: Evolution of budgetary targets in successive programmes

		2006	2007	2008	2009	2010
General government balance (% of GDP)	**SP Dec 2007**	**2.9**	**0.5**	**-0.9**	**-1.1**	**-1.0**
	SP Dec 2006	*2.3*	*1.2*	*0.9*	*0.6*	*n.a.*
	COM Nov 2007	2.9	0.9	-0.2	-0.6	n.a.
General government expenditure (% of GDP)	**SP Dec 2007**	**34.2**	**36.1**	**37.0**	**36.9**	**36.5**
	SP Dec 2006	*34.6*	*35.4*	*35.1*	*35.0*	*n.a.*
	COM Nov 2007	34.2	35.7	36.6	36.8	n.a.
General government revenue (% of GDP)	**SP Dec 2007**	**37.1**	**36.6**	**36.1**	**35.8**	**35.4**
	SP Dec 2006	*36.8*	*36.6*	*36.0*	*35.5*	*n.a.*
	COM Nov 2007	37.1	36.6	36.3	36.2	n.a.
Structural balance[1] (% of GDP)	**SP Dec 2007**	**2.9**	**0.5**	**-0.4**	**-0.5**	**-0.7**
	SP Dec 2006	*2.7*	*1.8*	*1.8*	*1.6*	*n.a.*
	COM Nov 2007	3.1	1.2	0.3	0.0	n.a.
Real GDP (% change)	**SP Dec 2007**	**5.7**	**4.8**	**3.0**	**3.5**	**4.1**
	SP Dec 2006	*5.4*	*5.3*	*4.6*	*4.1*	*n.a.*
	COM Nov 2007	5.7	4.9	3.5	3.8	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2006 and 0.2% in 2007 (all surplus-increasing) according to the most recent programme and 0.0% of GDP in 2006 and 0.0% in 2007 in the Commission services' autumn forecast. According to information presented by the national authorities, they represent the impact of (i) additional revenue secured through special investigations by the tax authorities, and (ii) the payment of an exit tax associated with special savings accounts (SSIAs). These one-offs were excluded in the autumn forecast in the absence of detailed information. No information on one-offs in the period 2008-2010 is provided in the programme.

Source:

Stability programmes (SP); Commission services' autumn 2007 economic forecasts (COM). The Commission services forecast did not include the impact of Budget 2008 but were completed on a no-policy change basis.

The programme posits that when a 'prudent contingency provision' for 2009 and 2010, equivalent to 0.4% and 0.8% of GDP respectively, is excluded from the calculation of the structural balance, the underlying deficit is consistent with the MTO in those years. The nature of this contingency provision is thus clearly crucial to an assessment of the budgetary strategy in the programme. On one hand, its inclusion in the budgetary projections may indicate prudent budgetary planning; on the other hand, it may simply be viewed as creating room for future deficit-increasing (or surplus-reducing) revenue and spending measures. The experience with the budgetary strategy for 2008 as outlined in the December 2006 update of the stability programme and earlier experience in 2001 suggests the second interpretation (see Box 3).

Box 3: The contingency provisions in the Irish stability programme updates

In the Irish stability programme updates, contingency provisions are normally foreseen for the last two programme years (years *t+2* and *t+3*) not covered by the budget. Little by way of further information is provided in the programme update. In the official budgetary documents, this item is described as a *"provision made against factors outside the control of government that may impact on the Budget but which cannot be foreseen at the time when the budgetary projections are carried out."* Given examples are variability in tax buoyancy and exceptional costs arising in areas of public expenditure. Contingency provisions can thus be viewed as a positive risk to the achievement of the programmes' budgetary targets, which is incorporated in the projections with a negative impact on the general government balance. Although it is claimed that it embodies a prudential approach in the budgetary projections, this incorporation seems to warrant the actual allocation of the foreseen amounts in the expenditure and revenue projections for the relevant years.

A comparison of the budgetary strategy in the 2006 and the 2007 updates of the stability programme illustrates this point. The December 2006 update of the stability programme envisaged a contingency provision for 2008 of 0.4% of GDP and targeted a structural surplus equivalent to 1¾ % of GDP. In the absence of the (prudential) contingency provision, this structural balance would have been expected to be of the order of 2 ¼ % of GDP. The December 2007 programme update targets instead, for the same year, a structural deficit at ½ % of GDP, with a deterioration well beyond the size of the contingency provision, reflecting mainly spending developments. Furthermore, analysis of past experience suggests that during periods of an unexpected economic slowdown, such as in 2001, expenditure overruns together with revenue underperformance contribute to worsening of the total budget balance by a significantly larger amount than is provided for by the contingency provisions. This suggests that although the inclusion of a contingency provision in the fiscal projections might be a prudent course of action to take in theory, experience seems to suggest a strong likelihood that they will be used especially in the event of a downswing.

4.2.2. The composition of the budgetary adjustment

The move from a nominal surplus in 2007 of 0.5% of GDP to a planned nominal deficit in 2008 of 0.9% reflects a projected rise in the expenditure ratio by 0.9 pp. and a contraction in the revenue ratio by 0.5 pp. Besides the impact of new, mainly spending, measures in the 2008 Budget (see Box 4), the projected rise in the expenditure ratio incorporates the impact of spending decisions in 2007 and earlier years, as well as further increases in investment spending which should help the long-term productive capacity of the economy. Lower revenue ratios reflect lower tax elasticities linked with the changing composition of growth to a less tax-rich configuration.

In 2009 and 2010, the revenue ratio is expected to continue declining, albeit less rapidly, while the expenditure ratio is projected to broadly stabilise in 2009 and to decline in 2010. Given the assumed economic background and the projected slight increases in the cost of debt servicing and in capital investment, the planned expenditure profile in those years implies a significant containment of current primary expenditure growth. The planned budgetary profiles for 2009 and 2010 explicitly incorporate unallocated contingency provisions of, respectively, 0.4% and 0.8% of GDP (see Section 4.2.1), but the programme does not specify the technical assumptions underlying the allocation of these amounts between revenue and expenditure headings. Nor does the programme provide any information about the measures supporting the envisaged budgetary strategy, in particular how the containment of current primary expenditure is intended to be achieved. The residual expenditure category ("other") shows a significant decline in pp. terms, especially in the light of the increase in spending in compensation and intermediate consumption, making the projected containment in spending from 2009 under this heading particularly difficult to assess (see Table 5).

An analysis of government at the sectoral level shows that the projected changes in the general government balance are reflected closely in the central government balance, with a modest reduction in the small social security sub-sector surplus. The local government sector (small in Ireland) remains close to balance throughout the programme period.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2006	2007	2008	2009	2010	Change: 2010-2007
Revenue	**37.1**	**36.6**	**36.1**	**35.8**	**35.4**	**-1.2**
of which:						
- Taxes on production and imports	14.1	13.6	13.4	13.3	13.1	**-0.5**
- Current taxes on income, wealth, etc.	13.2	12.9	12.6	12.4	12.3	**-0.6**
- Social contributions	6.3	6.4	6.4	6.4	6.4	**0.0**
- Other (residual)	3.5	3.7	3.7	3.7	3.6	**-0.1**
Expenditure	**34.2**	**36.1**	**37.0**	**36.9**	**36.5**	**0.4**
of which:						
- Primary expenditure	33.2	35.2	36.0	35.8	35.4	**0.2**
of which:						
Compensation of employees and intermediate consumption	14.7	15.3	16.1	16.2	16.1	**0.8**
Social payments	11.0	11.7	11.7	11.6	11.5	**-0.2**
Subsidies	0.5	0.7	0.7	0.7	0.7	**0.0**
Gross fixed capital formation	3.7	3.9	4.1	4.2	4.2	**0.3**
Other (residual)	3.3	3.6	3.4	3.2	3.0	**-0.6**
- Interest expenditure	1.0	0.9	1.0	1.1	1.1	**0.2**
General government balance (GGB)	**2.9**	**0.5**	**-0.9**	**-1.1**	**-1.0**	**-1.5**
Primary balance	**3.9**	**1.4**	**0.0**	**-0.1**	**0.0**	**-1.4**
One-off and other temporary measures	0.1	0.2	0.0	0.0	0.0	**-0.2**
GGB excl. one-offs	**2.8**	**0.3**	**-0.9**	**-1.1**	**-1.0**	**-1.3**
Output gap[1]	-0.2	-0.5	-1.3	-1.5	-0.7	**-0.3**
Cyclically-adjusted balance[1]	3.0	0.7	-0.4	-0.5	-0.7	**-1.4**
Structural balance[2]	**2.9**	**0.5**	**-0.4**	**-0.5**	**-0.7**	**-1.2**
Change in structural balance		*-2.4*	*-0.8*	*-0.1*	*-0.2*	
Structural primary balance[2]	3.9	1.4	0.6	0.6	0.4	**-1.0**
Change in structural primary balance		*-2.5*	*-0.7*	*0.0*	*-0.2*	

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance as recalculated by Commission services on the basis of the information in the programme.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme; Commission services' calculations

Box 4: The budget for 2008

The budget for 2008 was presented to the Dáil (lower house of Parliament) on 5 December 2007, together with the stability programme update. For the first time, the Minister of Finance presented a "single unified budget" where the key measures on the revenue and expenditure side are announced at the same time (see Section 6).

The budget for 2008 plans a general government balance (GGB) for 2008 of -0.9% of GDP, a considerably worse outcome than the estimated positive outturn of 0.5% of GDP in 2007. Slightly less than half of this is accounted for directly by new measures announced in the budget (mainly reflecting developments on the spending side) with the opening pre-budget deficit (on the basis of an "existing level of services", or no-policy change, scenario) projected at 0.4% of GDP, reflecting a lower revenue ratio and a rise in public investment.

The main measures announced in the 2008 Budget on the revenue and expenditure side are summarised in the table below, with an indication of their budgetary costs as a percentage of GDP. Expenditure measures amount to 0.6% of GDP and largely relate to increases in benefit payments and health-related spending. Welfare payments, including old age pensions, are being increased by around 6½%, which will make some progress towards meeting a commitment in the new programme for government to increase pension amounts (see Section 2).

Measures on the revenue side have also been announced, but overall the tax package in 2008 is broadly neutral with respect to the deficit, as the revenue estimates also take into account indirect effects of the budget. Total tax revenue (budget basis) is expected to grow by 3.3% in 2008, which is considerably slower than the projected rise in nominal GDP of 5.5%, reflecting reduced tax elasticities coupled with a broadly neutral tax package. It is noteworthy that a previous commitment to reduce the higher income tax rate from 41% to 40% was not implemented. Nor has the commitment in the new programme for government to reduce social contribution rates yet been acted upon.

Table: Main measures in the budget for 2008

Revenue measures*	**Expenditure measures****
o For personal incomes, more generous tax-exempt thresholds, widening of standard rate tax bands (-0.2% of GDP) o Reform and effective reduction in stamp duty on sale of residential properties (-0.1% of GDP)	o Increased social welfare payments (0.3% of GDP) o New long-term residential care scheme (0.1% of GDP) o Other health sector spending (0.1% of GDP) o Security and defence (0.1% of GDP)

* Estimated impact on general government revenues in Budget year.
** Estimated impact on general government expenditure in Budget year.

Sources: Commission services and Irish Department of Finance, *Budget 2008*.

4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period up to 2009, Table 6 compares the detailed revenue and expenditure projections in the Commission services' autumn 2007 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

Table 6: Comparison of budgetary developments and projections

(% of GDP)	2006	2007		2008		2009		2010
	COM	COM	SP	COM	SP	COM[1]	SP	SP
Revenue	**37.1**	**36.6**	**36.6**	**36.3**	**36.1**	**36.2**	**35.8**	**35.4**
of which:								
- Taxes on production and imports	14.1	13.8	13.6	13.5	13.4	13.5	13.3	13.1
- Current taxes on income, wealth, etc.	13.2	13.0	12.9	13.1	12.6	13.1	12.4	12.3
- Social contributions	6.3	6.4	6.4	6.4	6.4	6.3	6.4	6.4
- Other (residual)	3.6	3.5	3.7	3.4	3.7	3.3	3.7	3.6
Expenditure	**34.2**	**35.7**	**36.1**	**36.6**	**37.0**	**36.7**	**36.9**	**36.5**
of which:								
- Primary expenditure	33.2	34.8	35.2	35.6	36.0	35.8	35.8	35.4
of which:								
Compensation of employees and intermediate consumption	14.7	14.9	15.3	15.1	16.1	15.0	16.2	16.1
Social payments	11.0	12.0	11.7	12.4	11.7	12.7	11.6	11.5
Subsidies	0.5	0.5	0.7	0.5	0.7	0.5	0.7	0.7
Gross fixed capital formation	3.7	4.1	3.9	4.4	4.1	4.3	4.2	4.2
Other (residual)	3.3	3.3	3.6	3.3	3.4	3.3	3.2	3.0
- Interest expenditure	1.0	0.9	0.9	0.9	1.0	0.9	1.1	1.1
General government balance (GGB)	**2.9**	**0.9**	**0.5**	**-0.2**	**-0.9**	**-0.6**	**-1.1**	**-1.0**
Primary balance	**3.9**	**1.8**	**1.4**	**0.7**	**0.0**	**0.4**	**-0.1**	**0.0**
One-off and other temporary measures	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**2.9**	**0.9**	**0.3**	**-0.2**	**-0.9**	**-0.6**	**-1.1**	**-1.0**
Output gap[2]	-0.5	-0.7	-0.5	-1.2	-1.3	-1.3	-1.5	-0.7
Cyclically-adjusted balance[2]	3.1	1.2	0.7	0.3	-0.4	0.0	-0.5	-0.7
Structural balance[3]	**3.1**	**1.2**	**0.5**	**0.3**	**-0.4**	**0.0**	**-0.5**	**-0.7**
Change in structural balance		*-1.9*	*-2.4*	*-1.0*	*-0.8*	*-0.3*	*-0.1*	*-0.2*
Structural primary balance[3]	4.1	2.1	1.4	1.2	0.6	0.9	0.6	0.4
Change in structural primary balance		*-2.0*	*-2.5*	*-0.9*	*-0.7*	*-0.3*	*0.0*	*-0.2*

Notes*:*

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM) which were calculated on a pre-Budget 2008 basis; Commission services' calculations

As noted in Section 3, the programme's macroeconomic scenario can be regarded as broadly plausible, although with notable risks on both the external and domestic sides. In the light of the risks around the projection, the programme includes a sensitivity analysis assessing the impact on the budget balance of a 1 pp. deviation in the rate of real GDP growth from that in the central scenario throughout the period 2008-10. Two alternative sources of such deviation are considered, namely a change in interest rates and a change in world growth.[25] The short-run effect on the budget balance in 2008 is up to 0.1 pp, broadly the same irrespective of whether the source of the change is world growth or interest rates. The impact in the second

[25] The analysis in the programme is based on simulations of the HERMES model of the Economic and Social Research Institute (ESRI). The programme stresses that the results are indicative and subject to considerable uncertainty, and are based on the technical assumption of unchanged policies.

year (2009) is estimated to be larger in the case of an interest rate change (up to 0.4 pp. compared with up to 0.2 pp. for a change in world growth). By the third year (2010) the results are again similar, with a cumulative impact on the budget balance of 0.4/0.3 of a percentage point of GDP respectively (broadly symmetrical between upside and downside growth shocks).[26] Compared with the central scenario, the budget balance in the presence of a 1 pp. lower-than-projected economic growth due to a change in interest rates remains safely below the 3% of GDP deficit threshold, with the largest deficit at 1.5% of GDP in 2009.

A different kind of simulation made by the Commission services focuses on the cyclically-adjusted rather than the headline balance under the assumptions of: (i) a sustained 0.5 percentage point negative deviation from the real GDP growth projections in the programme over the 2007-2010 period; (ii) trend output based on the HP-filter; and (iii) no policy response (notably, the expenditure level is as in the central scenario). It shows that, by 2010, the cyclically-adjusted balance would be ¾ pp. of GDP lower than in the central scenario. Hence, in the event of persistently lower real growth (-0.5 pp. per year), additional corrective measures of around ¾ pp. of GDP would be needed to keep the public finances on the structural path targeted in the central scenario.

Table 7 shows the calculated tax elasticities from the programme along with those in the Commission services' autumn forecast. Both projections show tax elasticities that are considerably lower than the *ex-ante* OECD tax elasticities estimates. This seems to be broadly consistent with the picture whereby activity in the housing market returns to more sustainable levels (particularly affecting stamp duties and capital gains tax). However, the tax elasticities implied by the programme projections are lower than those implied by the autumn forecast. This could reflect the incorporation of part of the contingency provision.[27] The projected fall in the tax-to-GDP ratio (especially for taxes on income and wealth) in the programme thus looks cautious in the absence of specific policy announcements to implement further tax reductions, such as commitments to reduce the highest rate of personal taxation or social insurance contributions. These outstanding commitments (the former made in Budget 2007, while latter is included in the new political programme agreed by the new government parties after the election) constitute possible risks to the tax projections over the programme period. However, both commitments were made with general caveats about the favourable economic conditions under which they might be implemented, and this raises the possibility that they might be deferred until beyond the period of the stability programme update.

[26] These results are broadly in line with the budgetary sensitivity analysis carried out by the Commission services, which measures the impact of cyclical fluctuations on the general government balance.

[27] If, for instance, half of the contingency provision was attributed to cautious taxation and social contribution projections in 2009, this would have the effect of limiting the projected fall between 2008 and 2009 in the revenue-to-GDP ratios for these revenue sources to close to that envisaged in the autumn forecast (i.e. 0.3 pp. of GDP).

Table 7: Assessment of tax projections

	2008			2009			2010
	SP	**COM**[1]	**OECD**[3]	**SP**	**COM**[1]	**OECD**[3]	**SP**
Change in tax-to-GDP ratio (total taxes)	-0.5	-0.2	0.2	-0.3	-0.1	0.3	-0.3
Difference (SP – COM)	-0.3		/	-0.3		/	/
of which [2] *:*							
- discretionary and elasticity component	*n.a.*		/	*n.a.*		/	/
- composition component	*n.a.*		/	*n.a.*		/	/
Difference (COM - OECD)	/	-0.5		/	-0.3		/
of which [2] *:*							
- discretionary and elasticity component	/	*-0.7*		/	*-0.6*		/
- composition component	/	*0.4*		/	*0.4*		/
p.m.: Elasticity to GDP	0.7	0.9	1.1	0.8	1.0	1.1	0.8

Notes:

[1]On a no-policy change basis i.e. pre-Budget 2008.

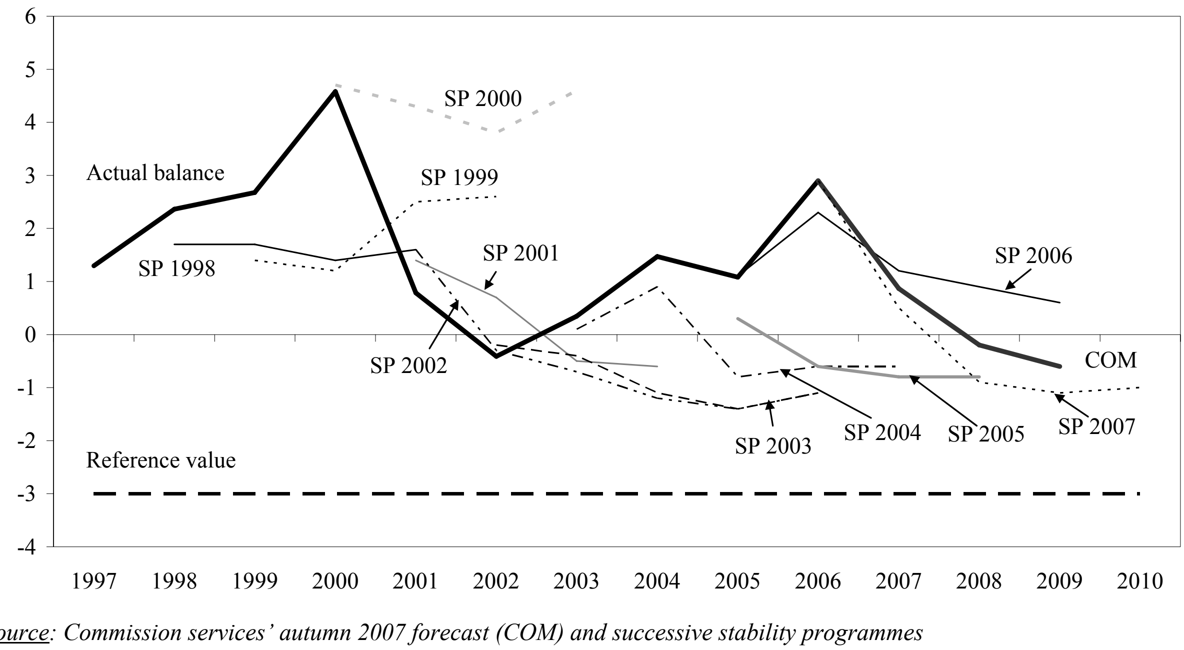
[2]The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.

[3]OECD ex-ante elasticity relative to GDP.

Source :

Commission services' autumn 2007 economic forecasts (COM) - calculated on a pre-Budget basis; Stability programme (SP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).

Figure 3: Government balance projections in successive programmes (% of GDP)

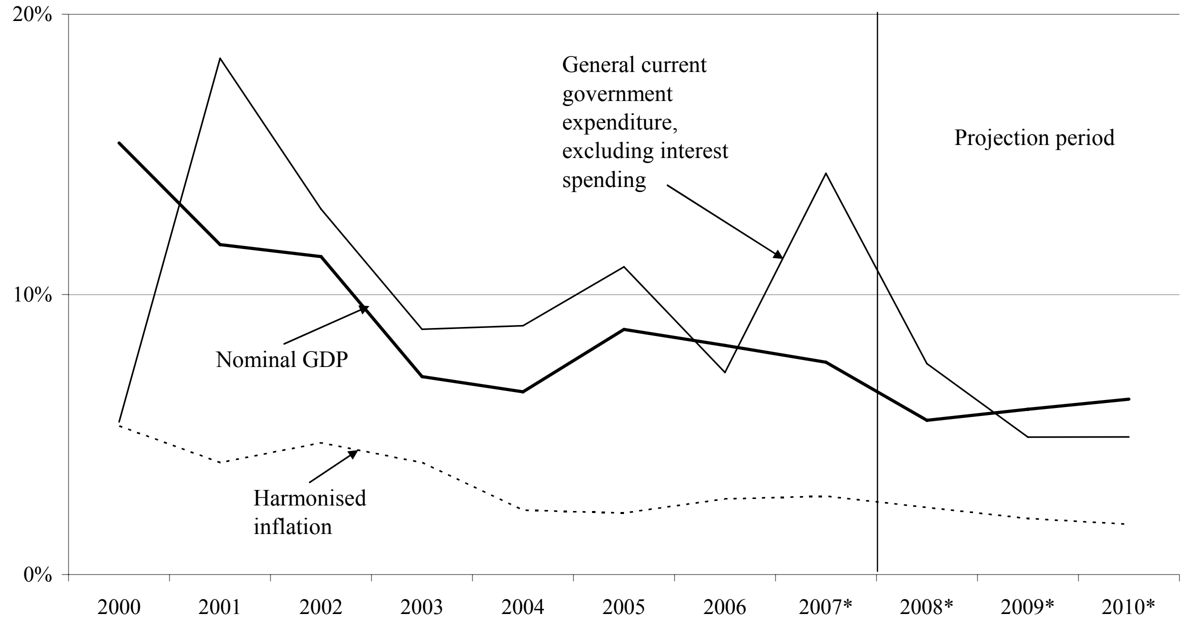


Source: Commission services' autumn 2007 forecast (COM) and successive stability programmes

An assessment of the plausibility of the programme's budgetary projections must take account of Ireland's overall track record with successive programmes in recent years. Figure 3 shows that, in recent years, outturns for the balance have generally been better than projected in successive stability programmes. On this account, therefore, the risk assessment to the budgetary projections in the current update might be favourable. However, it is noted that exceeding targets was greatly facilitated by very strong growth/revenue overshoots, whereas some expenditure overruns have occurred.

Figure 4 shows that the projected containment of current primary expenditure growth in the last two years of the programme contrasts with the experience in recent years, when spending growth at a rate higher than nominal GDP growth was the norm. What is more, the inclusion of contingency provisions (see Section 4.2.1) increases the projected expenditure ratios in 2009 and 2010 (given their assumed negative budgetary impact), and in the absence of these provisions, the projected rise in spending in those years would be even less than those shown. Much of the success in achieving the expenditure targets in the programme will depend on future developments in the two main items of current spending: compensation of employees and social transfers. For the former, the recent national agreements provide the broad mechanism for restoring a more moderate growth path, even if the opening new wage negotiations in 2008 provides a degree of uncertainty about future public sector wage costs; for the latter, the precise intention of the national authorities in relation to the appropriate benchmark and degree of indexation may not be very clear or subject to the interpretation of specific government commitments (for instance in relation to pension spending, see Section 2). Consequently, there appears to be risks on the downside attached to the relatively limited information on the broad measures underlying the expenditure strategy in the later years of the programme.

Figure 4: Projected annual percentage change in current primary expenditure



Note: * calculated from the December 2007 stability programme

Source: AMECO; Commission services calculations based on December 2007 programme

The lack of detailed information in relation to the local government sector may add a further small element of risk to the overall fiscal outcome insofar as development levies have become an important source of revenue for this sector of government. According to local government finance statistics, these amounted to around 0.3% of GDP in 2005 and are likely to have become more significant at the height of the residential construction boom. With the downturn in this sector, some impact on local government revenues and expenditure would be expected although there is not sufficient information to quantify this.

Overall, risks to the budgetary projections in the programme appear broadly balanced in 2008. From 2009, however, the risks appear somewhat tilted to the negative side despite relative cautiousness in tax projections, given the lack of information on what broad measures will be taken so as to contain current spending growth below nominal GDP growth. This is especially the case as regards the public wage bill and social transfer payments, both of which have increased substantially in recent years as a percentage of GDP. Furthermore, there are also risks on the revenue side associated with previous commitments to reduce tax and social insurance contribution rates. Moreover, while the inclusion of the contingency provisions in the budgetary projections could reflect prudent planning, it cannot be excluded that they may be used for future revenue-reducing and/or expenditure-increasing measures. Against these factors should be weighed Ireland's good track record, since the outturns for the fiscal balance have generally been better than projected in recent stability programmes.

4.4. Assessment of the fiscal stance and budgetary strategy

Table 8 offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks that are attached to the budgetary targets presented in the programme, this assessment is carried out in two stages: first, a preliminary assessment on the basis of the targets taken at face value and, second, the final assessment also taking into account risks.

Table 8: Overview of compliance with the Stability and Growth Pact

	Based on programme[3] (with the targets taken at face value)	**Assessment** (taking into account risks to the targets)
a. Safety margin against breaching 3% of GDP deficit limit[1]	Throughout programme period	Throughout programme period
b. Achievement of the MTO	Met in 2007; broadly met in 2008; slight departure thereafter	Met in 2007; broadly met in 2008; slight departure thereafter
c. Adjustment towards MTO in line with the Pact[2]?	May be insufficient to maintain MTO after 2008 and should be strengthened	May be insufficient to maintain MTO after 2008 and should be strengthened

Notes:
[1]The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the minimum benchmark (estimated as a deficit of around 1½% of GDP for Ireland). These benchmarks represent estimates and as such need to be interpreted with caution.
[2]The Stability and Growth Pact requires Member States to make progress towards their MTO (for countries in the euro area or in ERM II, this has been quantified as an annual improvement in the structural balance of at least 0.5% of GDP as a benchmark). In addition, the structural adjustment should be higher in good times, whereas it may be more limited in bad times.
[3]Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.

Source:
Commission services

While Ireland is expected to continue to meet its MTO in 2007 by a large margin through a further, albeit markedly reduced, budget surplus, the budgetary stance in the programme foresees that the structural balance will move into deficit in 2008 and worsen slowly but steadily thereafter, implying that it may be insufficient to maintain the MTO after 2008. While the MTO would be broadly reached in 2008, the fiscal stance thereafter could imply that the structural balance would move away from the MTO, which would not be in line with the Stability and Growth Pact. Specifically, the budgetary stance in the programme may be insufficient to maintain the MTO after 2008 unless the margins foreseen in the programme as contingency provisions remain unused (see Box 3). For the authorities not to use these provisions would imply a significantly better tax position and/or greater spending containment than shown in the programme, and this strengthening of the structural effort could therefore mean that the fiscal outturn would remain at the MTO and in line with the Pact.

The risks attached to the budgetary projections are broadly neutral for 2008, but from 2009, outcomes could be worse than projected in the absence of adequate expenditure containment, despite some evidence of cautious tax projections. As in 2007, the fiscal stance in 2008 until the end of the programme is expansionary but not necessarily pro-cyclical given that the economy is likely to be performing below potential. The programme implicitly argues that the negative impact of the contingency provisions contained in the budgetary projections for 2009 and 2010 should be disregarded, as embodying a prudential approach to the programme projections. However this argument seems to be valid only to the extent that tax projections are overly cautious and/or annual current spending growth during 2009 and 2010 can plausibly fall below that set out in the programme (specifically to about half of its 2008 rate). The lack of information in the programme update on broad measures to contain spending growth to the degree shown in the programme, let alone a more restrictive degree, tends to weaken the argument that the contingency provisions should be excluded from an assessment of the plausibility of the budgetary projections. These contingency provisions could represent fiscal space for additional expenditure and/or tax reductions, given previous commitments (see section 4.3). They may also reflect risks around the tax-intensity of growth linked with the future trajectory of the housing sector, as well as possible delays in securing restraint in spending from corrective measures which have yet to be announced. Given these uncertainties, in the event of a worsening of risks or a delay in containing current spending, Ireland may risk not reaching the targets shown in the programme or even, breaching a structural deficit of 1% of GDP.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

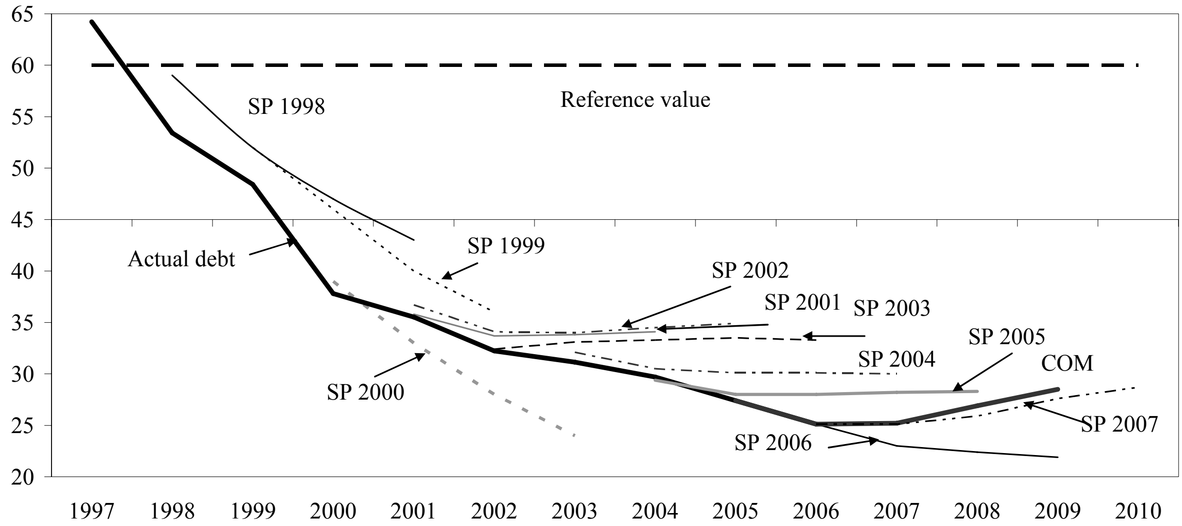
5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

The programme estimates that the gross debt-to-GDP ratio was 25.1% at the end of 2007, unchanged from end 2006 (see Figure 5). The new 2007 estimate gross debt ratio is higher than the previous programme's projection (23.0%) reflecting the worse than expected primary surplus, lower nominal GDP and a more sizeable debt-increasing stock-flow adjustment. The latter continues to be driven by the investment policies oriented towards private sector assets of the National Pensions Reserve Fund (NPRF), the public pension pre-funding vehicle to which by statute is transferred 1% of GNP each year. At end-September 2007, the NPRF held assets amounting to 11% of GDP.

Between 2007 and 2010 the gross debt-to-GDP ratio is projected to increase by more than 3.5 pps., as the primary balance targets and a smaller debt-decreasing impact from the "snow-ball" effect, due to lower nominal GDP growth, would no longer offset the persistently debt-increasing stock-flow adjustment (see Table 9).

Figure 5: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2007 forecast (COM) and successive stability programmes

5.1.2. Assessment

Projections of the gross debt developments in the programme until 2009 are more favourable than those in the Commission services' autumn 2007 forecast essentially because the latter include a persistently higher debt-increasing stock-flow adjustment, under the assumption of its stabilisation at the 2006 levels. On the other hand, the expected primary balances in the autumn forecast were more positive than now assumed in the programme. Overall, also looking at past track records, the debt projections in the programme appear plausible.

5.2. Long-term debt projections and the sustainability of public finances

This section analyses the long-term sustainability of public finances. It uses long-term projections of age-related expenditures to calculate sustainability gap indicators and make long-term government debt projections so as to assess the sustainability challenge the country concerned is facing.

Table 9: Debt dynamics

(% of GDP)	average 2002-05	2006	2007		2008		2009		2010
			COM	SP	COM	SP	COM	SP	SP
Gross debt ratio[1]	**30.0**	**25.1**	**25.2**	**25.1**	**26.9**	**25.9**	**28.5**	**27.6**	**28.7**
Change in the ratio	-2.0	-2.3	0.1	0.0	1.7	0.8	1.6	1.7	1.1
Contributions[2]*:*									
Primary balance	**-1.8**	**-3.9**	**-1.8**	**-1.4**	**-0.7**	**0.0**	**-0.4**	**0.1**	**0.0**
"Snow-ball" effect	**-1.3**	**-1.0**	**-0.7**	**-0.8**	**-0.4**	**-0.4**	**-0.6**	**-0.4**	**-0.6**
Of which:									
Interest expenditure	1.2	1.0	0.9	0.9	0.9	0.9	1.0	1.0	1.0
Growth effect	-1.6	-1.5	-1.2	-1.1	-0.8	-0.7	-1.0	-0.9	-1.1
Inflation effect	-0.9	-0.6	-0.5	-0.6	-0.5	-0.6	-0.6	-0.6	-0.5
Stock-flow adjustment	**1.1**	**2.7**	**2.7**	**2.3**	**2.8**	**1.2**	**2.6**	**2.0**	**1.7**
Of which:									
Cash/accruals diff.	-0.1	0.4		n.a.		n.a.		n.a.	n.a.
Acc. financial assets	1.0	2.2		n.a.		n.a.		n.a.	n.a.
Privatisation	*0.0*	*-0.1*		*n.a.*		*n.a.*		*n.a.*	*n.a.*
Val. effect & residual	0.3	0.0		n.a.		n.a.		n.a.	n.a.

Notes:

[1]End of period.

[2]The change in the gross debt ratio can be decomposed as follows:

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

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations

5.2.1. Sustainability indicators and long-term debt projections

Table 10 shows the evolution of government spending on pensions, healthcare, long-term care for the elderly, education and unemployment benefits according to the EPC's projections and property income received by general government according to an agreed methodology. Non age-related primary expenditure and primary revenue is assumed to remain constant as a share of GDP.

Table 10: Long-term age-related expenditure: main projections

(% of GDP)	2004	2010	2020	2030	2040	2050	Change up to 50
Total age-related spending	**15.5**	**15.4**	**17.1**	**18.8**	**20.7**	**23.3**	**7.8**
- Pensions	4.7	5.2	6.5	7.9	9.3	11.1	6.4
- Healthcare	5.3	5.5	5.9	6.4	6.9	7.3	2.0
- Long-term care	0.6	0.6	0.6	0.7	0.9	1.2	0.6
- Education	4.1	3.5	3.4	3.2	3.0	3.1	-1.0
- Unemployment benefits	0.7	0.6	0.6	0.6	0.6	0.6	-0.2
Property income received	**1.0**	**1.0**	**1.0**	**0.9**	**0.9**	**0.9**	**-0.1**

Source: Economic Policy Committee and Commission services.

The projected increase in age-related spending in Ireland is above the EU average, rising by 7.8 pp. of GDP between 2004 and 2050. This is particularly due to pension expenditure, projected to increase more than on average in the EU, by 6.4 pp. of GDP. The increase in health-care expenditure is projected to be 2.0 pp. of GDP, also above the EU average. For long-term care, the projected increase of 0.6 pp. of GDP up to 2050 is slightly below the EU average.

Based on the long-term budgetary projections, sustainability indicators can be calculated. Table 11 shows the sustainability indicators for the two scenarios; the 2007 scenario assumes that the structural primary balance in 2007 is unchanged for the remainder of the programme period and the programme scenario assumes that the programme's budgetary plans are fully attained. In the "2007 scenario", the sustainability gap (S2) which satisfies the intertemporal budget constraint would be 4.9% of GDP.[28]

Table 11: Sustainability indicators and the required primary balance

	2007 scenario			**Programme scenario**		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	1.3	4.9	5.9	2.5	6.1	5.9
of which:						
Initial budgetary position (IBP)	-1.2	-1.1	-	-0.1	0.1	-
Debt requirement in 2050 (DR)	-0.9	-	-	-0.9	-	-
Long-term change in the primary balance (LTC)	3.5	6.0	-	3.5	6.0	-

Source: Commission services.

The sustainability gap is significantly wider than in last year's assessment by around 2½pp. of GDP. This is mainly due to a lower estimated structural primary balance in 2007 (1.4% of GDP) compared with the structural primary balance in 2006 (3.9% of GDP as estimated lately and 3.7% of GDP as estimated in the assessment of the 2006/07 stability programme).

The initial budgetary position may only partly offset the long-term budgetary impact of ageing. Moreover, the programme plans a lowering of the structural primary budgetary surplus by 1 pp. of GDP between 2007 and 2010. This would appreciably increase the risks to long-term sustainability of public finances by widening the S2 sustainability gap ("programme scenario"), showing the importance of maintaining a strong structural budgetary position to contain risks to the sustainability of public finances. This is illustrated by the difference between the initial budgetary position in the '2007 scenario' and the 'programme scenario'. In the latter, the initial budgetary position is not expected to make any contribution to addressing the budgetary challenges arising from demographic developments.

The required primary balance (RPB) is almost 6% of GDP, significantly higher than the structural primary balance of about ½% of GDP in the last year of the programme's period.

Another way to look at the prospects for long-term public finance sustainability is to project the debt-to-GDP ratio over the long-term using the same assumptions as for the calculations of the sustainability indicators. The long-term projections for government debt under the two scenarios are shown in Figure 6. The gross debt ratio is currently well below the 60% of GDP reference value, estimated in the programme at close to 25% of GDP in 2007. According to the "2007 scenario", the debt ratio would remain around that level and increase significantly thereafter, eventually exceeding 60% of GDP by 2040 and reaching nearly 140% of GDP by

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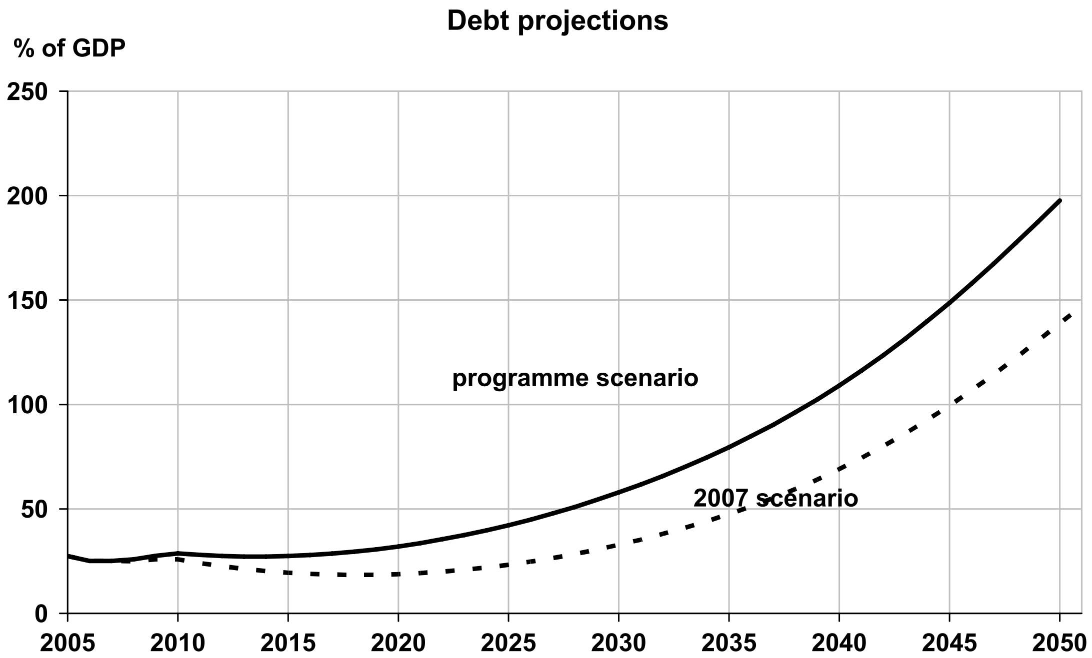
[28] The sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be 1.3% of GDP.

2050. In the "programme scenario", with the planned budgetary deterioration until 2010, the increase in the debt ratio would be more pronounced, surpassing 60% of GDP ten years earlier and reaching nearly 200% of GDP by 2050.[29]

Figure 6: Long-term projections for the government debt ratio



Source: Commission services

5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant factors are taken into account, which in addition allow to better appreciate where the main risks to sustainability are likely to stem from. First, in order to pre-fund part of the financing of future government spending pressures, assets are being accumulated in the National Pension Reserve Fund (NPRF), which reached over 11% of GDP in 2007. This results in an adjusted gross debt ratio (i.e. gross debt minus assets in public pension funds) of 14% in 2007. The government is obliged by statute to pay into the NPRF a sum equivalent to 1% of GNP each year until 2055, with drawdown prohibited prior to 2025.[30] Second, the Commission services' autumn forecast projects the structural surplus to decline by more than 1 percentage point of GDP between 2007 and 2009. Since this projection is based on a no-policy change scenario, the decline in the structural balance as planned by the programme appears plausible until 2009 (not withstanding the worse starting position in 2007 and developments in the structural

[29] It should be recalled, however, that being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

[30] For further analysis of the NPRF and its impact on long-tern sustainability, see European Commission, Directorate-General for Economic and Financial Affairs (2006), "Public Finances in EMU 2006", *European Economy*, No. 3, pp. 234-5.

balance as projected in the programme until 2010). Third, no new pension reforms have been signalled in the December 2007 stability programme update. The update indicates work in progress however, based on the Green Paper on Pensions,[31] which is a discussion document covering all aspects of the pension system – social welfare, public service and supplementary pensions. The update also refers to work in respect of public service pension reforms being advanced during 2007 with a view to bringing measures to government "in due course". A consultation process on the Green Paper is underway and is expected to last until at least summer 2008. The scale and scope of reforms, which might eventually be undertaken, is not clear at this stage.

Furthermore, the Green Paper on Pensions quotes new demographic projections based on the results of the 2006 census (see Section 6.2 of the stability programme). The national authorities have highlighted where possible, the broad agreement between the EPC projections and their own, but there are differences between the projections, in particular a slight worsening of the old-age dependency ratio compared with the EPC projections. According to the Green Paper, pension expenditure would be higher by about 2% of GDP in 2050 compared with the EPC projections.

5.2.3. Assessment

Ireland appears to be at medium risk with regard to the sustainability of public finances.

The long-term budgetary impact of ageing is well above the EU average, mainly because of a relatively high increase in pension expenditure over the coming decades, influenced in part by the maturing of the pension system. Yet, the gross debt ratio is well below 60% of GDP in 2007 and, in order to pre-fund part of this expenditure, assets are accumulated in the National Pension Reserve Fund (NPRF).

The budgetary position in 2007 as estimated in the programme, although worse than in the previous programme, still contributes to offsetting the projected long-term budgetary impact of ageing populations. However, this is not sufficient to cover future spending pressures. In addition, developments in the structural balance as projected in the programme until 2010 could put the sustainability of public finances at greater risk. Therefore, maintaining high primary surpluses over the medium term and implementing further measures aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risks to the sustainability of public finances.

6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

Chapter 5 of the stability programme update provides an overview of recently announced and ongoing measures to improve the quality of the public finances, while chapter 7 provides up-to-date information on institutional reforms. As regards the quality of public finances, it is stated that the overall objective is to raise the country's productive capacity through improvements in public infrastructure and the fostering of high-quality employment. The programme highlights the public investment framework in the National Development Plan 2007-2013 as the key priority, but also reports on progress in a range of specific actions,

[31] http://www.pensionsgreenpaper.ie/

including the establishment of a new Commission on Taxation to review the efficiency and effectiveness of the taxation system, initiatives aimed at enhancing the value-for-money of public spending through "annual output statements" by government departments and the publication of an annual "carbon report" which details progress in meeting targets and planned measures.

Chapter 7 similarly provides an overview of developments across a number of areas: the introduction of a 'unified budget' to replace the previously separate budget and estimates processes; actions to strengthen the involvement of public private partnerships (PPP) in public investment through the establishment of a centralised advisory service; developments in relation to public service pay and the modernisation programme for the public service; and an update on the government's decentralisation programme.

The most noteworthy development is the maintenance of a high and rising profile of public investment over the programme period despite the deterioration in the fiscal position generally.[32] Such spending can improve the long-term productive capacity of the economy and address concerns about competitiveness and the attractiveness of Ireland for foreign investment. Clearly, the management of this spending is critical if its full benefits are to be realised and the introduction of a range of management tools in recent years should help this. These include the introduction of a multi-annual framework, the centralisation of expertise supporting the management of public private partnerships and the introduction of new contract and procedures for construction procurement.

Previous programmes provided information on ongoing reviews of various tax incentives, particularly with a view to considering if their economic rationale remained valid. The current stability programme signals a broadening of this approach through the establishment of a Commission on Taxation to review the efficiency and effectiveness of the taxation system.

The Irish government recently invited the OECD to benchmark the Irish public service against other comparable countries and make recommendations for the future direction of public service reform. This review has the potential to have a significant impact on the nature and pace of the existing reform process in Ireland, which has been underway in its current phase since the 1990s.

The presentation of a single 'unified budget' is clearly an important institutional development in the evolution towards a transparent and coherent budgetary process and adds to a number of innovations in recent years such as multi-annual capital envelopes and the "value for money" framework. From Budget 2008, the key measures on both the spending and the revenue side of the public finances are announced at the same time. Previously, the main spending changes (with the notable exception of increases in benefit rates) were announced a few weeks before the budget, while the main tax and benefit rate changes were announced as part of the Budget, thus completing the fiscal picture for the coming year. Of itself, this innovation should strengthen the link between spending and revenue decisions, especially where certain revenue streams are earmarked for spending streams. The publication of a pre-budget outlook, which now includes pre-budget estimates of spending increases (i.e. on a no-policy change basis), should improve the understanding of the impact of spending decisions.

[32] Investment spending as % of GDP is projected to rise from 3.9% of GDP to 4.2% in 2009 and 2010 (Section 4).

The transparency of this exercise might be enhanced through the inclusion of further information on the components of this pre-budget spending increase, such as whether they represent the carryover costs of previous year's decisions, demand-led adjustments to spending programmes or indexation elements. In particular, it would be useful to provide the indicative amounts linked with hypothetical indexation of parameters affecting spending or revenue items (for example, benefit transfer schemes, personal income tax parameters).

7. CONSISTENCY WITH THE NATIONAL REFORM PROGRAMME AND WITH THE BROAD ECONOMIC POLICY GUIDELINES

The measures in the December 2007 stability programme update are broadly in line with the 2005 National Reform Programme (NRP) and its October 2007 implementation report. The stability programme confirms and emphasises the broad goal to sustain Ireland's strong economic growth and employment performance that was affirmed in the implementation report (see Box 5 providing a short summary of the Commission's assessment of Ireland's IRNRP). In particular, the programme update emphasises the government's commitment to an employment-friendly economic environment by maintaining a low overall tax burden and improve a range of public (mainly social) services, and links this explicitly with the goals set out in the Lisbon strategy. Overall, the measures in the budget for 2008 appear consistent with this objective.

Box 5: The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Ireland's national reform programme[33] and is summarised as follows.

Ireland's national reform programme 2005-2008 identified its key priorities as follows: maintain a stable macroeconomic environment, sustainable public finances, and moderate inflation levels; within this fiscal framework, continue to prioritise public investment in economic and social infrastructure and other growth-enhancing expenditures; ensure that the economy will be in a position to meet anticipated long-run fiscal pressures, including those arising from the ageing of the population.

The Commission's assessment was that "Ireland has been making very good progress in implementing its national reform programme over the 2005-2007 period. The Programme presents a clear strategy and takes an integrated approach based on synergies between the different areas". Against the background of progress made, the Commission states that is important for Ireland to focus on the areas of: pension reform; labour market participation; R&D investment; the carefully monitoring of developments in the housing market.

Furthermore, the measures aimed at improving strategic management of public expenditure (Section 6) move in the direction of redirecting resources towards more growth-enhancing categories, and as the programme points out are consistent with the 2005-08 Broad Economic Policy Guidelines (BEPGs). Finally, the high rate of public capital formation and the efforts

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33 Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.

to prioritise such expenditure give a graphic demonstration of this orientation towards facilitating growth.

Table 12: Consistency with the broad economic policy guidelines (integrated guidelines)

Broad economic policy guidelines (integrated guidelines)	Yes	Steps in right direction	No	Not applicable
1. To secure economic stability				
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it[1].	X (2007 and 2008)		X (from 2009(unless contingenc y provisions remain unused)	
– Member States should avoid pro-cyclical fiscal policies[2].				X
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits[3].				X
– Member States posting current account deficits that risk being unsustainable should work towards (…), where appropriate, contributing to their correction via fiscal policies.				X
2. To safeguard economic and fiscal sustainability In view of the projected costs of ageing populations,				
– Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances.			X (from 2008)	
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (…)		X		
3. To promote a growth- and employment-orientated and efficient allocation of resources				
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, 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.	X			

Notes:
[1]As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.
[2]As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in "good times".
[3]As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.

Source:
Commission services

Both the stability programme and the implementation report point to the importance of the Stability and Growth pact in terms of providing a framework for sustainable fiscal policies, while implementation of the National Development Plan 2007-2013 is highlighted in both documents as being the Government's key priority. However, the stability programme does not give detailed information on how the budgetary impact of measures embodied in the NRP is taken into account in the programme. It does not provide systematic information on the direct budgetary costs or savings associated with the main reforms in the NRP and whether the budgetary projections in the programme explicitly take into account the public finance implications of the reforms. Moreover, the stability programme does not contain qualitative assessment of the overall impact of the NRP within the medium-term fiscal strategy. Despite the absence of detail in the stability programme, the two programmes show broad correspondence and it can be concluded that the two programmes seem to be consistent.

Table 13 provide an overview of whether the strategy and policy measures in the stability programme are consistent with the broad economic policy guidelines in the area of public finances issued in the context of the Lisbon strategy for growth and jobs.

Table 12 makes the assessment against the integrated guidelines for the period 2005-2008, adopted by the Council in July 2005. Table 13 makes the assessment against the country-specific points to watch and the recommendations for the euro area, adopted by the Council in March 2007. Overall, the budgetary strategy in the programme is broadly consistent with the country-specific broad economic policy guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy.

Table 13: Consistency with the broad economic policy guidelines (country-specific recommendations and points to watch)

Broad economic policy guidelines (country-specific recommendations and points to watch)	Yes	Steps in right direction	No	Not applicable
1. Country-specific recommendations				
– *None*				X
2. Points to watch				
– speeding up progress in pension reform;		X		
– carefully monitor developments in the housing market which affect short and medium-term growth.		X		
3. Recommendations for euro area Member States				
– Make use of the favourable cyclical conditions to aim at or pursue ambitious budgetary consolidation towards their medium-term objectives in line with the Stability and Growth Pact, hence striving to achieve an annual structural adjustment of at least 0.5% of GDP as a benchmark				X
– Improve the quality of public finances by reviewing public expenditure and taxation, with the intention to enhance productivity and innovation, thereby contributing to economic growth and fiscal sustainability		X		
Source: *Commission services*				

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ANNEX 1: COMPLIANCE WITH THE CODE OF CONDUCT

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

(i) Model structure

The programme update broadly adheres to the code of conduct model structure. The programme uses the broad section outline with subsections corresponding well to the model structure. Two significant exceptions to this arise in section 2 given the absence of a subsection on sectoral balances and the growth implication of structural reforms. The programme in addition, provides a useful comparison of the main macroeconomic forecasts for Ireland in 2008.

(ii) Data requirements

All compulsory data have been provided with the exception of short-term interest rates.[34] Gaps in optional data remain as follows: Table 1b (deflators for public consumption and investment); Table 1c (labour productivity, hours worked);Table 1d (components of sectoral balances); Table 2 (general government compensation of employees and intermediate consumption); Table 3 (general government expenditure by function); Table 4 (decomposition stock-flow adjustment; liquid financial assets and net financial debt); Table 7 (total revenue and decomposition into property income and social insurance contributions; decomposition of pension reserve fund assets).

The tables on the following pages show the data presented in the December 2007 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.	X		
… indicates whether Council opinion on previous programme has been presented to national parliament.	X		
b. Economic outlook			
… (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.	X		
… explains significant divergences with Commission services’ forecasts[1].	X		
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.		X	A short outline of the factors underlying the evolution of the external balance is included in Section 2
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable

[34] Short-term interest rates provided on a confidential basis.

The SCP…	Yes	No	Comments
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.	X		
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X - reasons	X - measures	
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.		X	Fiscal projections contain a general provision for current spending increases equivalent to 0.7% and 1.3% of GDP in 2009 and 2010. These are not supported by references to broad measures.
… specifies state of implementation of measures.		X	
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Not applicable
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		

Notes: SCP = stability/convergence programme; CP = convergence programme
[1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Table 1a. Macroeconomic prospects

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Real GDP	B1*g	*170760*	5.7	4.8	3.0	3.5	4.1
2. Nominal GDP	B1*g	*174704*	8.2	7.6	5.5	5.9	6.3
Components of real GDP							
3. Private consumption expenditure	P.3	*80823*	5.7	6.6	3.8	3.9	4.0
4. Government consumption expenditure	P.3	*24074*	5.3	4.8	3.6	2.9	2.8
5. Gross fixed capital formation	P.51	*43377*	3.1	1.5	-1.6	2.3	3.1
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*1367*	0.8	0.4	0.3	0.1	0.1
7. Exports of goods and services	P.6	*137969*	4.4	6.8	5.6	5.2	5.0
8. Imports of goods and services	P.7	*117178*	4.4	5.9	4.5	4.3	4.1
Contributions to real GDP growth							
9. Final domestic demand		-	4.2	4.0	1.9	2.7	3.0
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.7	-0.4	-0.1	-0.2	0.0
11. External balance of goods and services	B.11	-	0.6	1.3	1.3	1.1	1.2

Table 1b. Price developments

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. GDP deflator		*n.a.*	2.3	2.7	2.5	2.3	2.1
2. Private consumption deflator		*n.a.*	2.1	3.4	2.9	2.1	2.1
3. HICP[1]		*n.a.*	2.7	2.8	2.4	2.0	1.8
4. Public consumption deflator		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
5. Investment deflator		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
6. Export price deflator (goods and services)		*n.a.*	1.3	1.1	1.5	1.7	1.7
7. Import price deflator (goods and services)		*n.a.*	3.3	2.0	1.7	1.8	1.9

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*2039*	4.4	3.5	1.1	1.3	1.5
2. Employment, hours worked[2]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[3]		*93*	4.4	4.6	5.6	5.6	5.5
4. Labour productivity, persons[4]		*n.a.*	1.2	1.2	1.8	2.2	2.5
5. Labour productivity, hours worked[5]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
7. Compensation per employee		*n.a.*	n.a.	n.a.	optional	optional	optional

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-4.2	-4.4	-3.9	-3.5	-3.1
of which :						
- Balance on goods and services		n.a.	n.a.	n.a.	n.a.	n.a.
- Balance of primary incomes and transfers		n.a.	n.a.	n.a.	n.a.	n.a.
- Capital account		n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	n.a.	n.a.	n.a.	n.a.	n.a.
3. Net lending/borrowing of general government	EDP B.9	2.9	0.5	-0.9	-1.1	-1.0
4. Statistical discrepancy		0.6	0.5	0.5	0.5	0.5

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*5107*	2.9	0.5	-0.9	-1.1	-1.0
2. Central government	S.1311	*966*	0.6	0.2	-1.1	-1.4	-1.2
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*185*	0.1	-0.1	-0.1	-0.1	-0.1
5. Social security funds	S.1314	*594*	0.3	0.4	0.3	0.3	0.3
General government (S13)							
6. Total revenue	TR	*64845*	37.1	36.6	36.1	35.8	35.4
7. Total expenditure	TE[1]	*59738*	34.2	36.1	37.0	36.9	36.5
8. Net lending/borrowing	EDP B.9	*5107*	2.9	0.5	-0.9	-1.1	-1.0
9. Interest expenditure	EDP D.41	*1781*	1.0	0.9	1.0	1.1	1.1
10. Primary balance[2]		*6888*	3.9	1.4	0.0	-0.1	0.0
11. One-off and other temporary measures[3]		*250*	0.1	0.2	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*47977*	27.5	26.7	26.2	25.9	25.7
12a. Taxes on production and imports	D.2	*24607*	14.1	13.6	13.4	13.3	13.1
12b. Current taxes on income, wealth, etc	D.5	*23034*	13.2	12.9	12.6	12.4	12.3
12c. Capital taxes	D.91	*336*	0.2	0.2	0.2	0.2	0.2
13. Social contributions	D.61	*10924*	6.3	6.4	6.4	6.4	6.4
14. Property income	D.4	*1794*	1.0	1.1	1.2	1.2	1.1
15. Other [4]		*4150*	2.4	2.5	2.4	2.3	2.2
16=6. Total revenue	TR	*64845*	37.1	36.6	36.1	35.8	35.4
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			34.0	33.3	32.8	32.6	32.3
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*25678*	14.7	15.3	16.1	16.2	16.1
17a. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
17b. Intermediate consumption	P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
18. Social payments (18=18a+18b)		*19163*	11.0	11.7	11.7	11.6	11.5
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*2983*	1.7	1.8	1.9	1.8	1.8
18b. Social transfers other than in kind	D.62	*16180*	9.3	9.9	9.9	9.8	9.7
19=9. Interest expenditure	EDP D.41	*1781*	1.0	0.9	1.0	1.1	1.1
20. Subsidies	D.3	*912*	0.5	0.7	0.7	0.7	0.7
21. Gross fixed capital formation	P.51	*6498*	3.7	3.9	4.1	4.2	4.2
22. Other[6]		*5706*	3.3	3.6	3.4	3.2	3.0
23=7. Total expenditure	TE[1]	*59738*	34.2	36.1	37.0	36.9	36.5
p.m.: Government consumption (nominal)	P.3	*27919*	16.0	16.5	17.2	17.5	17.2

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2005	2010
1. General public services	1	n.a.	n.a.
2. Defence	2	n.a.	n.a.
3. Public order and safety	3	n.a.	n.a.
4. Economic affairs	4	n.a.	n.a.
5. Environmental protection	5	n.a.	n.a.
6. Housing and community amenities	6	n.a.	n.a.
7. Health	7	n.a.	n.a.
8. Recreation, culture and religion	8	n.a.	n.a.
9. Education	9	n.a.	n.a.
10. Social protection	10	n.a.	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	n.a.	36.5

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Gross debt[1]		25.1	25.1	25.9	27.6	28.7
2. Change in gross debt ratio		-2.3	0.0	0.8	1.7	1.1
Contributions to changes in gross debt						
3. Primary balance[2]		3.9	1.4	0.0	-0.1	0.0
4. Interest expenditure[3]	EDP D.41	1.0	0.9	1.0	1.1	1.1
5. Stock-flow adjustment		2.9	2.1	1.2	2.0	1.7
of which:						
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		n.a.	n.a.	n.a.	n.a.	n.a.
of which:						
- privatisation proceeds		-0.1	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt[7]		4.0	3.8	4.1	4.4	4.1
Other relevant variables						
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	**2006**	**2007**	**2008**	**2009**	**2010**
1. Real GDP growth (%)		5.7	4.8	3.0	3.5	4.1
2. Net lending of general government	EDP B.9	2.9	0.5	-0.9	-1.1	-1.0
3. Interest expenditure	EDP D.41	1.0	0.9	1.0	1.1	1.1
4. One-off and other temporary measures[1]		0.1	0.2	0.0	0.0	0.0
5. Potential GDP growth (%)		5.8	5.1	4.0	3.7	3.4
contributions:						
- labour		2.0	1.7	0.9	0.8	0.6
- capital		2.0	1.9	1.7	1.6	1.6
- total factor productivity		1.6	1.4	1.3	1.2	1.2
6. Output gap		-0.3	-0.5	-1.5	-1.7	-1.0
7. Cyclical budgetary component		-0.1	-0.2	-0.6	-0.7	-0.4
8. Cyclically-adjusted balance (2 - 7)		3.0	0.7	-0.3	-0.4	-0.6
9. Cyclically-adjusted primary balance (8 + 3)		4.0	1.6	0.7	0.7	0.5
10. Structural balance (8 - 4)		2.9	0.5	-0.3	-0.4	-0.6

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	**2006**	**2007**	**2008**	**2009**	**2010**
Real GDP growth (%)						
Previous update		5.4	5.3	4.6	4.1	n.a.
Current update		5.7	4.8	3.0	3.5	4.1
Difference		0.3	-0.5	-1.6	-0.6	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		2.3	1.2	0.9	0.6	n.a.
Current update		2.9	0.5	-0.9	-1.1	-1.0
Difference		0.6	-0.7	-1.8	-1.7	n.a.
General government gross debt (% of GDP)						
Previous update		25.1	23.0	22.4	21.9	n.a.
Current update		25.1	25.1	25.9	27.6	28.7
Difference		0.0	2.1	3.5	5.7	n.a.

Table 7. Long-term sustainability of public finances[1]

% of GDP	2005	2010	2020	2030	2040	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	15.2	15.4	17.1	18.8	20.7	23.3
Pension expenditure	4.6	5.2	6.5	7.9	9.3	11.1
Social security pension	3.4	3.8	4.5	5.5	6.8	8.4
Old-age and early pensions	2.3	2.5	3.3	4.2	5.5	7.1
Other pensions (disability, survivors)	1.1	1.2	1.3	1.3	1.3	1.3
Occupational pensions (if in general government)	1.2	1.4	2.0	2.4	2.6	2.7
Health care	5.3	5.5	5.9	6.4	6.9	7.3
Long-term care *(this was earlier included in the health care)*	0.6	0.6	0.6	0.7	0.9	1.2
Education expenditure	4.0	3.5	3.4	3.2	3.0	3.1
Other age-related expenditures	0.7	0.6	0.6	0.6	0.6	0.6
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	8.0	11.1	18.1	26.0	28.3	21.9
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	3.3	3.8	2.2	1.7	1.7	1.7
Real GDP growth	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 rates 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	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

[1] Years used are 2005, 2010, 2020, 2030, 2040 and 2050.

Table 8. Basic assumptions

	2006	2007	2008	2009	2010
Short-term interest rate[1] (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	4.3	4.4	4.5	4.5
USD/€ exchange rate (annual average) (euro area and ERM II countries)	n.a.	1.36	1.42	1.42	1.42
Nominal effective exchange rate	n.a.	2.4	1.2	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	5.6	5.3	5.4	5.4
EU GDP growth	n.a.	2.9	2.4	2.4	2.4
Growth of relevant foreign markets	n.a.	5.9	5.4	5.7	5.7
World import volumes, excluding EU	n.a.	7.8	7.1	7.7	7.7
Oil prices (Brent, USD/barrel)	n.a.	70.6	78.8	76.0	76.0

[1]If necessary, purely technical assumptions.

ANNEX 2: KEY INDICATORS OF PAST ECONOMIC PERFORMANCE

This annex displays key economic indicators that summarise the past economic performance of Ireland. To put the country's performance into perspective, right-hand side of the table displays the same set of indicators for the euro area.

Table: Key economic indicators

	Ireland						Euro area					
	Averages			2005	2006	2007	Averages			2005	2006	2007
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
Economic activity												
Real GDP (% change)	7.5	9.7	5.4	5.9	5.7	4.9	2.1	2.7	1.4	1.5	2.8	2.6
Contributions to real GDP growth:												
Domestic demand	*5.8*	*7.6*	*4.1*	*6.7*	*5.0*	*3.4*	*2.0*	*2.7*	*1.3*	*1.7*	*2.6*	*2.4*
Net exports	*1.7*	*2.0*	*1.3*	*-1.0*	*0.6*	*1.4*	*0.1*	*0.0*	*0.1*	*-0.1*	*0.2*	*0.2*
Real GDP per capita (PPS; EU27 = 100)	131	120	142	146	147	147	113	114	112	110	110	109
Real GDP per capita (% change)	6.0	8.6	3.5	3.6	3.1	2.9	1.6	2.5	0.8	0.9	2.3	2.2
Prices, costs and labour market												
HICP inflation (%)	3.0	2.7	3.4	2.2	2.7	2.8	1.9	1.5	2.2	2.2	2.2	2.0
Labour productivity (% change)	3.1	3.8	2.4	1.2	1.4	1.5	1.2	1.5	0.8	1.0	1.4	1.1
Real unit labour costs (% change)	-1.3	-2.8	0.2	1.1	0.8	1.5	-0.5	-0.6	-0.5	-0.8	-0.9	-0.8
Employment (% change)	4.3	5.7	2.9	4.7	4.3	3.3	1.2	1.5	0.9	0.9	1.5	1.6
Unemployment rate (% of labour force)	6.1	7.8	4.4	4.3	4.4	4.5	9.1	9.8	8.5	8.9	8.3	7.3
Competitiveness and external position												
Real effective exchange rate (% change)	1.2	-2.0	4.4	2.2	1.9	4.0	-1.3	-5.5	2.8	-2.6	-0.6	0.6
Export performance (% change)[1]	4.8	8.3	1.3	-0.5	-2.3	1.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.0	2.4	-0.4	-3.4	-4.0	-4.5	0.8	0.9	0.7	0.3	0.0	0.1
Public finances												
General government balance (% of GDP)	1.4	2.2	0.7	1.2	2.9	0.9	-2.3	-2.1	-2.5	-2.5	-1.5	-0.8
General government gross debt (% of GDP)	43.0	55.0	31.1	27.4	25.1	25.2	70.6	72.2	69.0	70.3	68.6	66.6
Structural balance (% of GDP)[2]	n.a.	n.a.	1.1	1.0	3.1	1.2	n.a.	n.a.	-2.6	-2.1	-1.1	-0.7
Financial indicators												
Short-term real interest rate (%)[3]	-0.1	0.5	-0.7	-0.5	0.8	2.1	1.3	2.5	0.6	0.3	1.2	2.0
Long-term real interest rate (%)[3]	1.1	1.3	0.8	0.6	1.4	2.2	n.a.	n.a.	1.9	1.5	1.9	2.1

Notes:
[1]Market performance of exports of goods and services on export-weighted imports of goods and services of 35 industrial markets.
[2]Cyclically-adjusted balance net of one-off and other temporary measures; available since 2003.
[3]Using GDP deflator.

Source:
Commission services