

**Financial Emergency Measures
in the Public Interest Act 2009
(No. 41 of 2009)**

**Annual review and report
to the Houses of the Oireachtas
by the Minister for Finance
under section 7 of the Act**

June 2011

I – Introduction and Background

1. Section 7 of the Financial Emergency Measures in the Public Interest (No. 2) Act 2009 (No. 41 of 2009) obliges the Minister for Finance before 30 June in 2011 and every year after 2011, to:
 - (a) carry out a review of the operation, effectiveness and impact of this Act, having regard to the overall economic conditions in the State and national competitiveness,
 - (b) consider whether or not any of the provisions of this Act continue to be necessary having regard to the purposes of this Act, the revenues of the State and Exchequer commitments in respect of public service pay and pensions,
 - (c) make such findings as he or she thinks appropriate consequent on the review and consideration, and
 - (d) cause a written report of his or her findings resulting from the review and consideration to be prepared and laid before each House of the Oireachtas.
2. The purpose of the Financial Emergency Measures in the Public Interest (No. 2) Act 2009 was to provide for the reduction of the remuneration of certain persons in the Public Service (including members of the Houses of the Oireachtas and certain Office Holders), and to provide for related matters.
3. In understanding the purpose and policy underpinning the Act as approved by the Oireachtas, it is useful to note the Act's preamble:

“WHEREAS a serious disturbance in the economy and a decline in the economic circumstances of the State have occurred and are continuing, which threaten the well-being of the community;

AND WHEREAS it is necessary to take urgent measures to reduce the significant shortfall between expenditure and revenue and to reduce the unsustainable levels of public borrowings consequent on the deterioration in those revenues;

AND WHEREAS it is necessary to reduce State expenditure to maintain international confidence and to protect the State's credit ratings;

AND WHEREAS it is necessary to take urgent steps to help to restore the State's competitiveness;

AND WHEREAS it is necessary for the State to achieve significant savings in its expenditure, both directly and indirectly, on remuneration;

4. This report is carried out in accordance with section 7 of the Act.
5. The sections which follow review the overall economic conditions in the State, national competitiveness and Exchequer commitments in respect of public service remuneration , and represent my findings in the light of that review in accordance with section 7 (c) of the Act.

II - Economic Context

6. The Irish economy experienced an extremely sharp downturn from peak to trough resulting in a cumulative fall of over 12.6 per cent in real in real GDP. Sharp declines in domestic investment (circa 60 per cent) and consumption (12 per cent) in conjunction with the downturn in our major trading partners are the main reasons for this unprecedented contraction in economic activity.
7. There are indications that the economy is over the worst with positive economic growth of 0.8 per cent anticipated for 2011. The recovery is then expected to strengthen in the following years. The emerging recovery is being led by exports. Emerging data indicates that weakness in the domestic economy will persist in the short to medium term, while strong external demand and competitiveness improvements are aiding our export performance. Export-led growth is less employment-intensive than domestically-driven growth, while recovery in the labour market typically lags that in the overall economy. As a result, the unemployment rate is expected to remain elevated.
8. Between 2000 and 2008, the Irish economy experienced a significant loss in competitiveness reflecting exchange rate, cost and price developments. Our international price competitiveness, for example, deteriorated by about one quarter in the decade to 2008. This resulted in a sharp moderation in export growth. Policy since then has been relatively successful at reversing this trend but Ireland still has some way to go to regain price competitiveness, particularly in the domestically traded services sector.
9. There is evidence that price and wage levels are adjusting to the new circumstances – improving Ireland’s competitiveness. Consumer prices declined in 2009 and 2010. While they have turned positive this year, they are still likely to remain below the euro area average helping to reduce the gap in price levels. Over the past decade pay increases exceeded productivity. Thus, adjustments observed over the past couple of years in wages are helping to restore competitiveness.

10. The labour market has been particularly affected by the recession. The standardised rate of unemployment was 14.1 per cent in May 2011 having been 4.8 per cent in early 2008. Whilst the unemployment rate has fallen from the 14.8 per cent figure observed in November 2010 and appears to be stabilising, some of this reflects falling labour supply (through outward migration and lower participation rates). Employment levels have also fallen by over 320,000 from their peak.

III - Budget context

11. The Irish public finances, in particular tax receipts, have been very severely affected by the sharp deterioration in economic activity. Tax revenues in 2010 at €31.8 billion, were down 4 per cent on the 2009 outturn. This followed declines of 19 per cent in 2009 and 14 per cent in 2008.
12. Tax revenues in 2010 were therefore some 33 per cent, or one third, below their 2007 peak, effectively back to 2003 levels. In contrast, gross voted current expenditure has grown by around 65 per cent since 2003. As a result of the very significant adjustment measures implemented in Budget 2011, including the introduction of the Universal Social Charge, tax revenues in 2011 are projected to rise by almost 10 per cent to €34.9 billion. However, this is still almost €700 million less than the amount collected as far back as 2004.
13. The gap that has emerged between revenues and expenditure is not sustainable. Even excluding the effect of once-off banking-related expenditures, the March 2011 Maastricht Returns showed that the General Government deficit in 2010, at 12.0 per cent of GDP, was the highest in the EU. In nominal terms, this was a General Government deficit of €18.5 billion. The headline deficit, including banking-related expenditures, stood at 32.4 per cent of GDP.
14. Since mid-2008, very significant action has been taken to tackle the imbalances in the public finances. A series of revenue-raising and expenditure-reducing measures designed to yield about 5 per cent of GDP in 2009 were implemented between July 2008 and April 2009 in order to help restore order to the public

finances. The measures introduced included a reduction in the public service pay bill through the introduction of the public service pension-related deduction, the introduction of an income levy, and the strict containment of expenditure across all Government Departments.

15. Further significant action was taken in Budget 2010, which announced an adjustment of €4 billion or 2.5 per cent of GDP. The main focus of Budget 2010 was on reducing expenditure and included reductions in remuneration to public servants effected under the terms of the Financial Emergency Measures in the Public Interest (No. 2) Act 2009. Other significant reductions were effected in social welfare spending, in programme spending of Government Departments and in capital expenditure.
16. The most recent round of fiscal measures – Budget 2011 – implemented an adjustment package of some €6 billion. In line with successful international and domestic experience of fiscal consolidation, the bulk of the adjustment is being made on the expenditure side, with €4 billion being implemented through expenditure reductions, including further reductions in social welfare payments and child benefits rates and reductions to public service pensions and the pay of new entrants to the public service.
17. In total since July 2008, six separate policy announcements of significant budgetary consolidation have been made and budgetary adjustments designed to yield some €21 billion or over 13 per cent of GDP have been implemented. These adjustments have been wide-ranging and have included reductions in public service pay, social welfare rates, programme expenditure and capital expenditure and a significant widening of the tax base. This has led to a slowdown in the growth of day-to-day public expenditure, from an increase of 12.1 per cent in 2007 to an estimated contraction of 2.7 per cent this year. This reduction has been achieved in the face of considerable pressures associated with rising numbers on the Live Register and the downturn in the economic cycle.
18. Despite the very considerable fiscal adjustments that have taken place, international markets became progressively less receptive to Irish Government borrowing during 2010. The erosion of confidence in international markets was

manifested in a steady increase in the spread on Irish Government bonds, that is the higher premium demanded by investors to purchase Irish Government bonds compared to the German benchmark. As a result, in November of last year, Ireland entered into a programme of external financial support with the EU and IMF.

19. The joint EU/IMF Programme of Financial Support provides a facility for the State to draw down up to €85 billion if required. The State will contribute €17½ billion of this amount through the National Pensions Reserve Fund and other domestic cash sources, while the external assistance will amount to €67½ billion. The objective of the Programme is to restore financial market confidence in the banking sector and the sovereign. To this end, the Programme contains a comprehensive schedule of budgetary targets, as well as banking and structural reform targets, to be achieved over the coming months and years. Consequently, continued access to funding under the Programme is conditional upon the delivery of the budgetary adjustments agreed under the terms of the Programme and outlined in the Memorandum of Understanding. As the cost of borrowing on international financial markets remains prohibitive, it is vital that the terms of the Programme are adhered to so that we can continue to access funding at reasonable rates of interest.
20. The new Government committed to reducing the General Government deficit to under 3 per cent of GDP by 2015. The Government is also committed to the aggregate fiscal adjustment which underpins the Joint EU/IMF Programme for the period 2011-2012, which includes a €3.6 billion budgetary adjustment for 2012. In preparation for Budget 2013, the Government will review progress on deficit reduction to ensure that the 3 per cent of GDP deficit target is reached by 2015.
21. The adjustments made since mid-2008 have been wide-ranging and have affected all sectors of society. Public service pay has been cut by approximately 14 per cent on average through the imposition of the public service pension-related deduction and reduction in pay rates with higher reductions for higher paid public servants and Ministers. Social welfare rates have been reduced as has programme spending across Government Departments.

22. In spite of the measures taken, the Stability Programme Update (SPU) published at the end of April 2011 and submitted to the European Commission, forecast that the General Government deficit would still be 10 per cent of GDP this year, over three times the limit set under the European Stability and Growth Pact.
23. However, the most recent Exchequer Returns covering the period to end-May show that the action taken in managing the public finances is working. Tax revenues are on target and expenditure is being managed within the amounts set out, demonstrating the impact of the expenditure control decisions taken. As such budgetary targets for this year remain valid at this time.
24. Over the period 2011-2015, while undertaking the planned budgetary consolidation, it will still be necessary for the Exchequer to undertake very considerable borrowing. Current projections for Exchequer borrowing needs, including banking recapitalisations costs, are that close to an additional €75 billion will be borrowed over this five year period. This means that an increasing proportion of available resources will be used to service the national debt – by 2013 it is estimated that the interest element of servicing the national debt will account for one-fifth of all tax revenue, up from just 3.5 per cent of tax revenue in 2007.
25. The National Debt at end-2010 was estimated to be €93 billion. It is currently estimated to increase to €122 billion by end-2011. By contrast, at end-2007, it was €38 billion.
26. Borrowing at our current levels is not a long-term solution. As debt servicing costs have first call on resources, an increasing debt interest burden will lead to higher interest costs, thereby adding to the burden on taxpayers, it will reduce our productive capacity, increase unemployment and reduce the scope for providing public services in the future.
27. This underlines the importance of continuing to take the necessary action to restore stability to the public finances. We must ensure that the State's resources are not absorbed paying ever-increasing debt bills but are instead available for the

provision of public services. This in turn will help return the economy to a sustainable growth path.

28. Over the period 2011-2015, it is expected that growth will return to the Irish economy on an annual basis and that modest growth in tax revenues will resume.
29. However, the tax base is now much reduced and economic growth will be primarily export-driven, which may not be as tax rich. As a result, the expected pick-up in tax revenues, based on existing policies, would not in itself bridge the significant gap that has emerged in the public finances.

IV – Cost of Public Service Remuneration

30. In 2009 the gross Exchequer public service paybill was €17.514 billion.¹ The Act provided the legislative basis necessary to facilitate a reduction in the gross paybill cost of public servants (Exchequer funded and local government) by some €1billion in 2010. The Act provided for reductions in the remuneration of public servants of between 5% and 20% effective from 1 January 2010.
31. The pay reductions applied under the Act, allied with some other measures to reduce the cost of the pay bill, achieved a saving in the gross Exchequer public service pay bill of in excess of €1billion in 2010. The (estimated) outturn for 2010 was €15.925 billion, a saving of €1.589 billion.
32. The estimated Exchequer pay bill for 2011 is €15.707 billion, a reduction of 1.37% over the outturn of €15.925 billion in 2010. Exchequer spending on public service pensions is estimated to be over €2 billion in 2011.

¹ The Exchequer pay bill does not include the pay bill for public servants in local government, which is funded differently. The Act applied to the pay rates of those public servants, and savings were therefore also achieved in those costs.

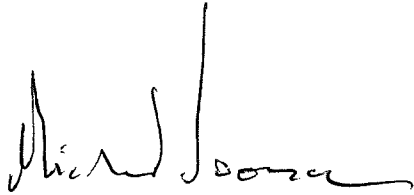
V - Operation, Effectiveness and Impact of the Act

33. I am satisfied that the Act has operated effectively since its inception. In particular I am satisfied that the measures contained in the Act have attained their primary objective of delivering critically necessary savings to the public finances and the Exchequer.

VI - Consideration of the need to continue the Act's provisions

34. Having considered the matter in line with section 7 of the Act, I am satisfied having regard to the purposes of the Act, the overall economic conditions in the State, national competitiveness and Exchequer commitments in respect of public service pay and pensions that the measures put in place by the Act continue to be needed. In this context the persistence of very challenging economic and public finance conditions is a critical consideration.
35. The Act was introduced in the context of the priority to be given to the stabilisation of the public finances. Under the EU/IMF Programme of Financial Support for Ireland, Ireland is committed to achieving the fiscal targets set out under Budget 2011 and the National Recovery Plan 2011-2014. Moreover, the Programme provides that the Government will consider an appropriate adjustment, including to the overall wage bill, to compensate for potential shortfalls in the projected savings arising from administrative efficiencies and public service number reductions.
36. The fiscal targets in Budget 2011 are based on the reduced remuneration rates provided for under the Act and the Government has committed under the Joint Programme for Government to adhering to the aggregate adjustment as set out in the National Recovery Plan for the combined period 2011-2012.
37. The target for the Exchequer can only be met by the maintenance of the provisions for the continued reduction of the remuneration of public servants provided for under the Act.
- 38.

- Consequent on this review and my consideration of same, I find that there is a need to continue to apply the reductions in remuneration of public servants, and other measures controlling the cost of the public service pay bill, provided for under the Act.

A handwritten signature in black ink, appearing to read 'Michael Noonan', with a long vertical stroke extending upwards from the 'n'.

Michael Noonan T.D.

Minister for Finance

June 2011