

# **Recovery through Reform – A Budget Perspective**

**A Fine Gael Pre-Budget Analysis and Strategy  
for Economic Recovery**

# 1. Introduction and Overview

While the banking crisis is clearly global, in the “real economy” Ireland is facing a more severe reversal than other advanced countries. We have been the first to enter the recession. Unemployment is rising more quickly here than in any other country. And we are witnessing the worst deterioration in the public finances of any euro zone country since the beginning of Economic and Monetary Union (EMU).

While many countries are experiencing economic challenges in the face of the global financial crisis, our economy is now nose-diving at an accelerating pace.

This is because the Irish economy is almost uniquely exposed. Of any EU country, we had the biggest property boom, the biggest exposure to the construction sector, the highest level of private indebtedness to GDP and the biggest lost of competitiveness.

The economic principles that delivered the prosperity of the Celtic Tiger – keeping costs down, high productivity, export-led growth, tight budgeting and prudent regulation of the financial sector and housing market – were all abandoned by the previous Government, and most notably Brian Cowen as Minister for Finance.

Already the hurt caused has been severe. The hundreds of small businesses that have gone to the wall. The thousands of debt-distressed home-owners finding it difficult to make ends meet. The tens of thousands of young families in negative equity. And the 100,000 additional people on the dole queue.

The Irish people are now exposed to a very dangerous situation. So far the Government's only response has been to prune back on capital spending and apply a uniform cut to all wage bills outside the Health and Education sector. There has been no strategic re-think of how Government delivers services efficiently and effectively, no forensic search for waste, no imaginative ideas about how to create jobs through new sources of competitive advantage for Ireland.

The Budget presents an opportunity for this Government to undo its mistakes of the past and set a new course for Irish public services and the economy that helps to restore consumer and business confidence.

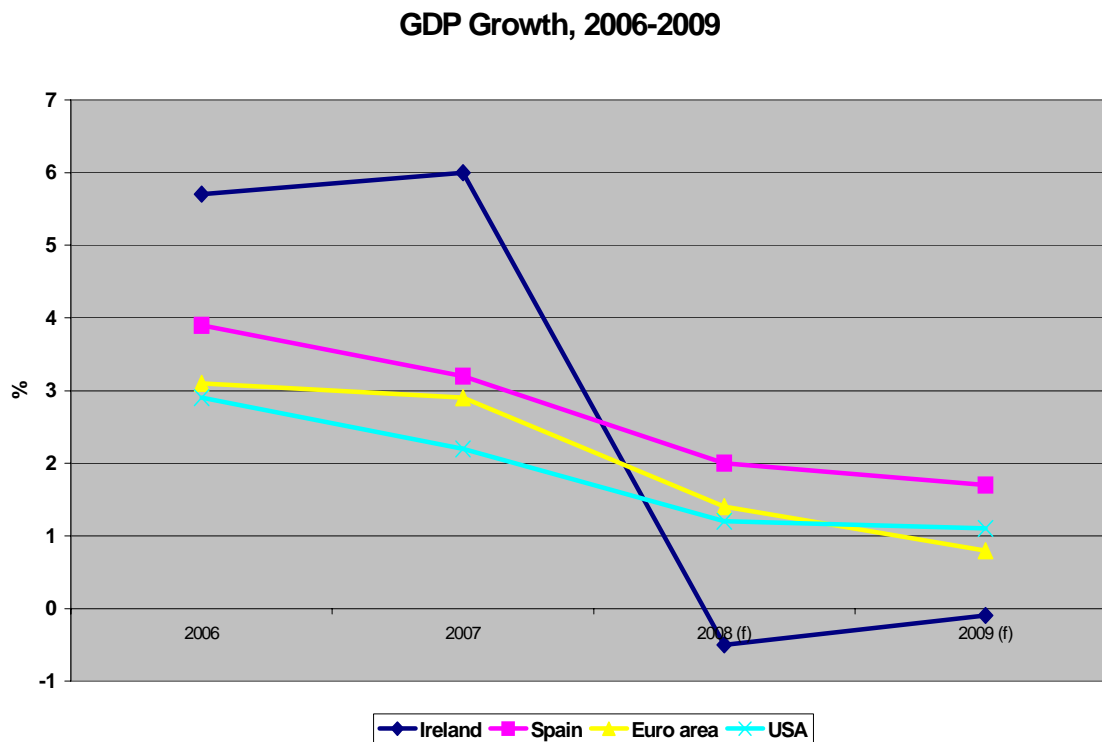
This opportunity cannot be wasted. More big mistakes by Government now would irreparably damage confidence and threaten to turn the current recession into a prolonged depression.

Now is the time for a courageous and visionary budget that:

- 1. Avoids the usual soft options**
- 2. Implements “tough but fair” measures to stabilise borrowing**
- 3. Starts the structural changes needed to root out waste and inefficiency**
- 4. Helps those most affected to adapt and protect the vulnerable**
- 5. Sets out a plan to reinvent our economic success**

## 2. Pre-Budget Economic Analysis

*While the banking crisis is global, in the “real economy” Ireland is facing a more severe economic crisis than most other advanced countries.....*



Source: Economist Intelligence Unit, Country Reports, September 2008

Two successive quarters of negative economic (GDP) growth in the first half of 2008 meant that the Ireland is the only country in the euro-zone to have formally entered recession. After four years with Brian Cowen at the wheel, the Irish economy has been slammed into a brick wall.

The figures show that GNP, which is the measure of domestic incomes, is now taking a sharper hit than GDP, as ordinary people are suffering by being laid off and taking pay cuts. Consumer confidence shows a dramatic collapse, with a 3% decline in retail spending in the second quarter alone.

And every week sees forecasters revise down their projections for 2008 and 2009. The latest revision comes from the ESRI, which earlier this week projected that the recession would be considerably deeper and longer than previously anticipated.

It predicts that living standards will drop by an unprecedented 8.6% over the two years. This will entirely wipe out of the improvements of the previous two years.

While many countries are experiencing slower economic growth in the face of global difficulties, our economy is now nose-diving at an accelerating pace.

Between this year and last, the rate of economic decline in Ireland is over three times that of the UK, and over seven times that of the euro-zone as a whole.

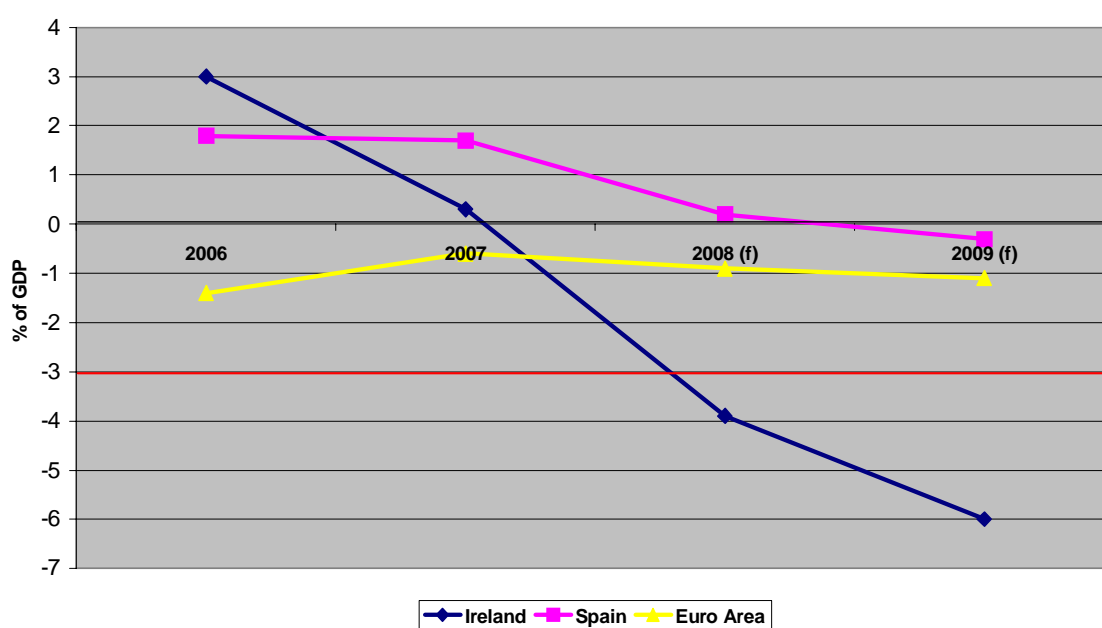
Indeed, among all advanced (OECD) countries:

- Ireland is suffering the biggest collapse in economic growth this year;
- Ireland will have the second biggest increase in unemployment this year;
- Ireland is seeing the worst deterioration in its public finances.

	Decline in Growth (GDP)	Decline in Gov. Bal (as a % of GDP)	Increase in Unemployment (%)
Ireland	-7.0%	-6.0%	+1.6%
UK	-1.9%	-0.7%	+0.1%
USA	-0.4%	-2.4%	+0.8%
Euro Area	-0.9%	-0.5%	-0.2%
OECD	-0.9%	-1.0%	+0.1%

Of particular concern is the extent of the deterioration of Ireland's public finances, which are deteriorating at a rate 12 times faster than the euro area average. Ireland is now expected to have the worst deterioration in the Government finances of any euro area country since Economic and Monetary Union began.

**General Government Balance, 2006-09**



On top of the financial “credit crunch” and the global rise in oil and other commodity prices, our economy is also suffering from the collapse of an exceptional debt-fuelled housing bubble (which began in early 2007 – long before the credit crunch) and a sustained loss of export competitiveness beginning as far back as 2001-02.

Contrary to Brian Cowen’s assertions, therefore, the extent of Ireland’s economic difficulties are unique, mostly domestic in origin, and relate to big mistakes made by the previous Government in public spending, competitiveness and housing.

**... Because the Last Government Destroyed the Fundamentals of the Celtic Tiger**

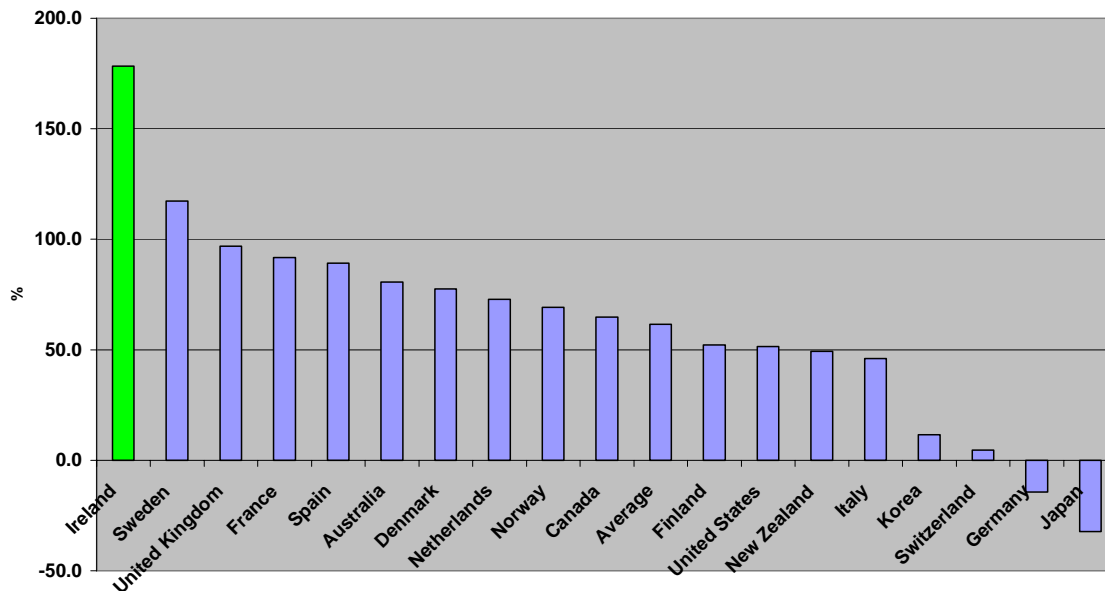
During the 1990s, the prosperity of the Celtic Tiger was built on solid foundations:

- Low inflation and cost competitiveness
- High productivity and export success
- A sound, well regulated financial system and housing market
- Tight management of the public finances

But these foundations were steadily undermined by Brian Cowen and the last Government through a number of big policy mistakes.

Firstly, they helped to stoke up the biggest housing market bubble in the world, threatening the stability of our financial system and economy.

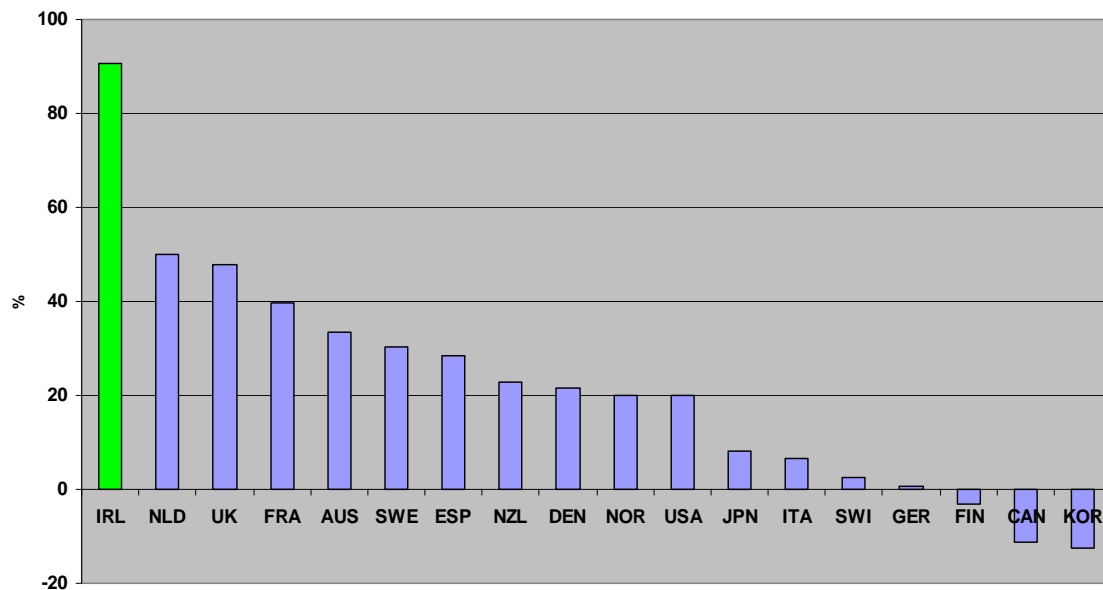
**Increase in House Price to Rent Ratio, 1997-2006**



Average house prices in Ireland doubled between 2000 and 2006, and tripled between 1997 and 2006.

Data from the IMF (see charts) confirm that the growth in Irish house prices was extraordinary, even by comparison with the UK and USA, and could not be explained by economic factors like rising incomes, employment and lower interest rates.

### Difference Between Actual and Explainable Housing Price Growth 1997-2006 (IMF)



The housing boom was driven by rising debt, rather than solid economic fundamentals. By 2007, Irish household debt was by far the highest in the euro area (as a % of GDP).

As debt levels and mortgage repayments reached historical highs, housing prices and output finally stalled in late 2006 – long before the start of problems in international markets. The problems in Irish housing are domestic, not international, in origin.

According to the ESRI, house prices have now fallen by 12% since their peak in January 2007. According to Davy, a further 10% fall in house prices will mean of the 100,000 first time buyers who purchased since 2005, at least 40,000 will be in negative equity. A 20% fall would see 65,000 first time buyers in negative equity.

These estimates do not include other home-owners that leveraged off the equity in the primary homes to invest in second or third properties, and whose combined debts may now exceed the value of their properties.

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As well as the thousands of young Irish families now stranded in negative equity, Mr Cowen’s housing boom and bust will leave other long-lasting economic legacies:

- The Irish economy has been left with an artificially-inflated cost base that will make difficult to regain competitiveness and export share.
- Tens of thousands of houses in tax-driven developments were built in the wrong places far away from centres of employment, many of which now lie empty.
- As employment in house-building is not expected to return to the 2006 peak, there are thousands of young Irish workers with the wrong skills and experience.
- The high mortgage repayment burden means that Irish households are uniquely vulnerable to disruptions to employment and income.
- The banking sector is over-extended and is restricting lending to young home buyers and for productive investment by small- and medium-sized companies

The housing bust has exposed the fallacy of Mr Cowen's claims to superior economic management skills and he only has himself to blame for this debacle. But instead of acknowledging the big mistakes of the past, we have a Taoiseach and Finance Minister that seek to deflect blame to everybody but themselves:

- They blame international banks
- They blame No voters at the Lisbon Treaty referendum
- They blame the opposition parties for talking the economy down
- We have even seen the Minister for Finance blame the Irish people for the housing boom, when he said on RTE radio "You know, we have to be honest about this as a people. We decided as a people collectively to have this housing boom."

All of these excuses ignore the huge policy mistakes made by Mr Cowen while Minister for Finance that undermined the stability of the Irish housing market and threatened the livelihoods of thousands of Irish families.

- He took the decision in 2005 to extend massive tax reliefs on property investment (hotels, holiday camps, holiday cottages, third level buildings, and student accommodation etc.) past the subsequent election in 2007, despite analysis by consultants in 2004 that these reliefs were contributing to over-investment and over-heating in the property sector, and were no longer a cost effective means of fulfilling their regional and socio-economic objectives.
- For three years running – 2005-07 – when the housing sector was already over-heating because of low interest rates, tax reliefs and easy credit conditions, he ignored explicit warnings by the IMF, ESRI and Central Bank about the danger of his expansionary budgets on Ireland's economic stability and competitiveness.
- Not only did he directly recklessly inflate the housing market with tax reliefs and expansionary budgets, but he also misused the authority of his office by talking up housing market when there were increasing dangers for both young families and the wider economy. At the peak of the credit cycle and housing boom in 2006, Minister Cowen assured potential buyers at every opportunity that Irish house prices were based on "strong fundamentals". Anyone who questioned this was accused of "talking down the economy".
- For example, in a speech to the National Mortgage Conference in January 2006, Minister Cowen reported that that "there is a consensus that the Irish mortgage

and housing market has been strong over an extended period of years because the economic fundamentals of the Irish economy have been strong”. But no such consensus existed. Indeed, only three months previously, the IMF had explicitly warned Mr Cowen that "house price overvaluation in Ireland is large compared to other countries" and could not just be explained by economic fundamentals.

- Despite having powers available to him, Mr Cowen did nothing to stop reckless property-related lending by the banks. Given the green light from Mr Cowen, banks further loosened their lending standards (40 year mortgages, 100% loans). Mortgage lending and house price inflation, having both moderated in 2005, re-accelerated to over 30% and 15% respectively in the first half of 2006. As a result, family indebtedness in Ireland is now the second highest in Europe.

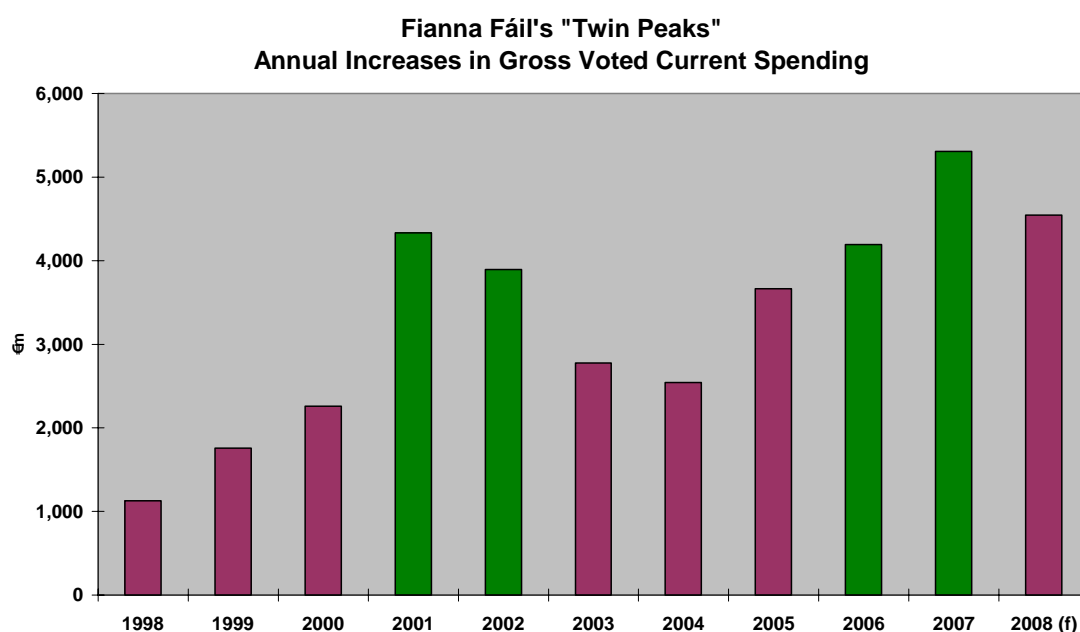
***Brian Cowen delivered reckless budgets that destroyed our competitiveness and eliminated our room for manoeuvre during a downturn***

Another big mistake by Brian Cowen and the last Government was not to use his four budgets to lower inflation, protect our competitiveness and prepare our public finances for the inevitable downturn in the property market.

But budget strategy under Mr Cowen was entirely shaped by short-term electoral, not long-term economic, considerations.

All of four budgets were designed to be inflationary, when inflationary budgets were the last thing that the economy needed in 2005-07.

This boom-and-bust pattern has severely damaged Ireland’s economic resilience and ability to respond to the downturn.



Now the cupboard has been left bare at the very time that an expansionary budget is needed.

***Unsustainable spending growth was financed by a temporary windfall from property taxes***

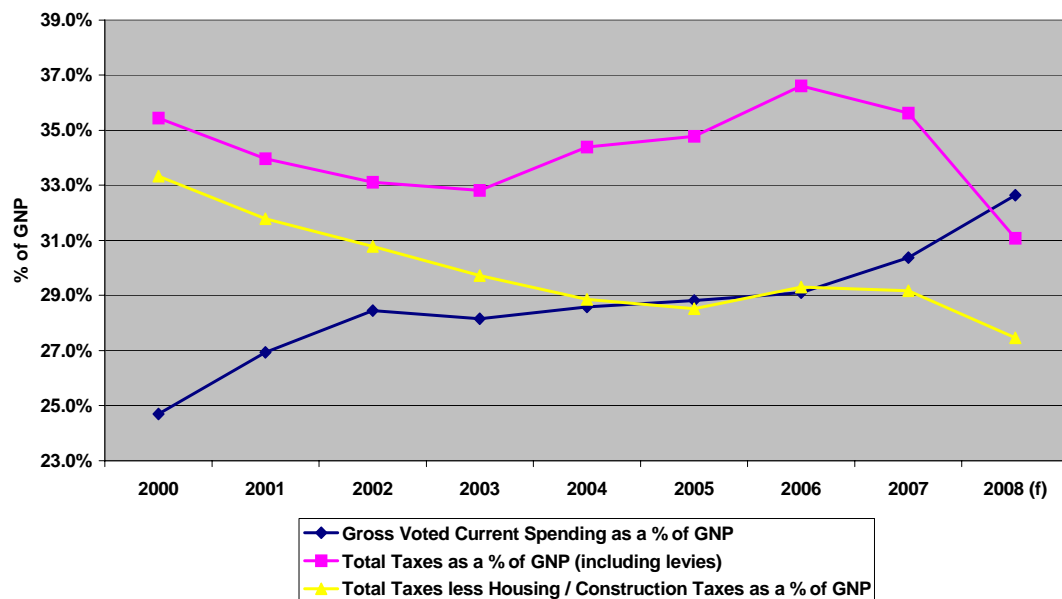
By urging on the property boom during 2004-07, Brian Cowen generated a huge tax bonanza for his Government.

This allowed him to increase spending dramatically faster than the rate of growth of the economy, but without having to resort to the traditional tax sources to fund the extravagance. Most commentators did not even notice the increasing reliance on the property sector for the big expansion of spending programmes. However, the end of the debt-fuelled property boom has shown it up in stark relief.

- Government spending has for seven years now averaged growth 40% faster than the rate of growth in the economy.
- Current spending has grown as a proportion of GNP from under 25% in the year 2000 to almost 33% now.
- His spending spree was financed entirely out of the growing tax windfall from the over-heating housing and construction sectors. At the same time that current spending was being ramped up, non-construction and housing taxes as a % of GNP fell by almost six percentage points.
- Taxes on housing and construction filled the gap, rising from just under € billion in 2000 (6% of tax revenues) to just under €1 billion by 2006 (20% of tax revenues).

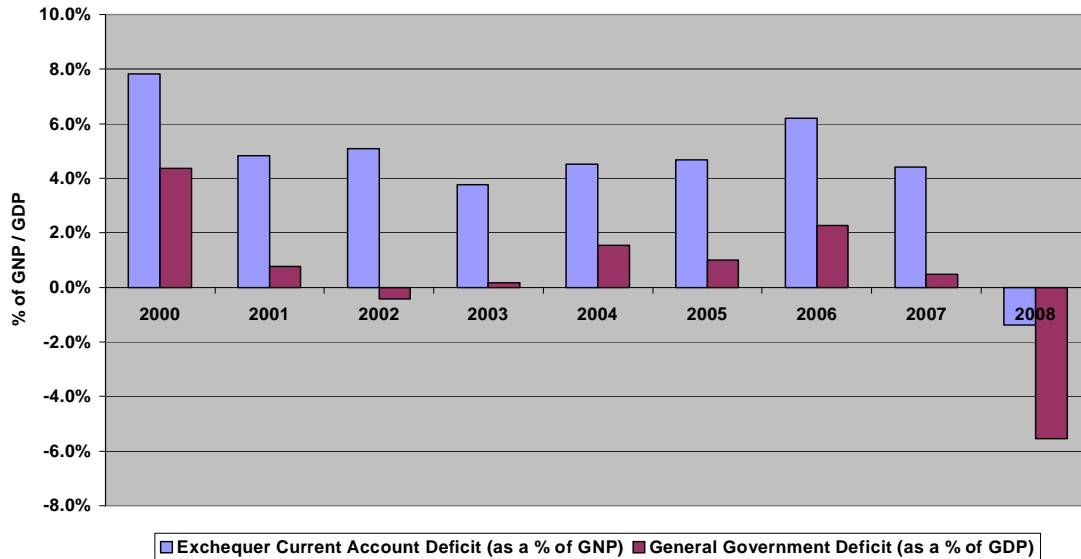
These windfall taxes from the property market were never sustainable, but were used by Cowen for his reckless and wasteful spending before the 2007 election.

**Taxation and Voted Current Spending 2000-08**



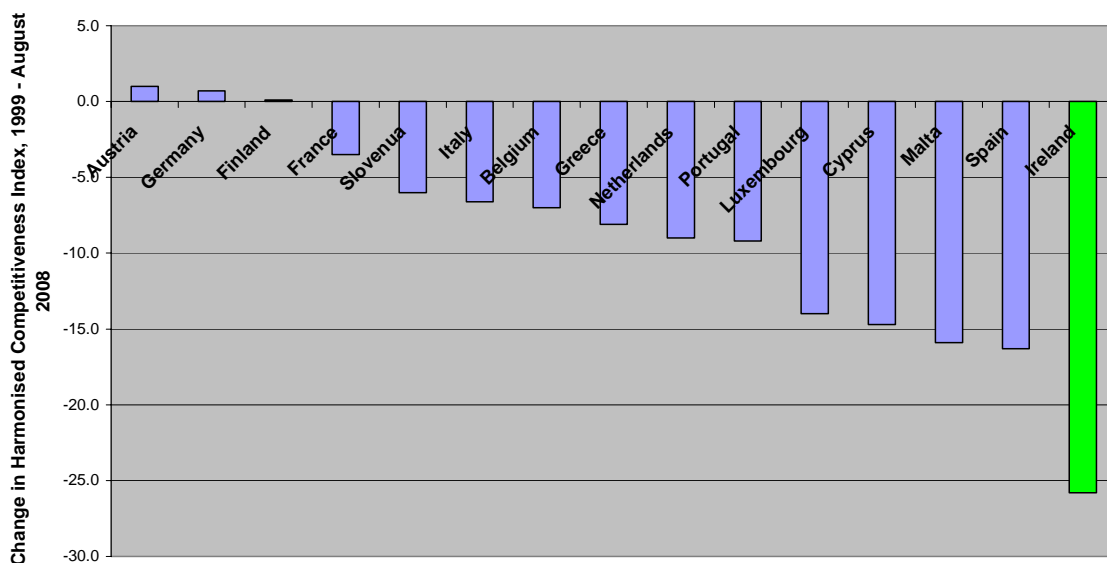
Now that the tide has turned and the property tax windfall has disappeared, we are now left with huge unfunded spending commitments and a gaping €12bn hole in the public finances. This was reckless incompetence of the highest order that now threatens future service improvements and infrastructure programmes.

### The Precipitous Decline of the Public Finances



*Ireland's cost competitiveness and productivity has been shattered because Brian Cowen and the last Government ducked all the difficult reform decisions needed to deliver efficiency, value for money and economic transformation*

### Change in Price Competitiveness of Euro Area Countries, 1999-2008



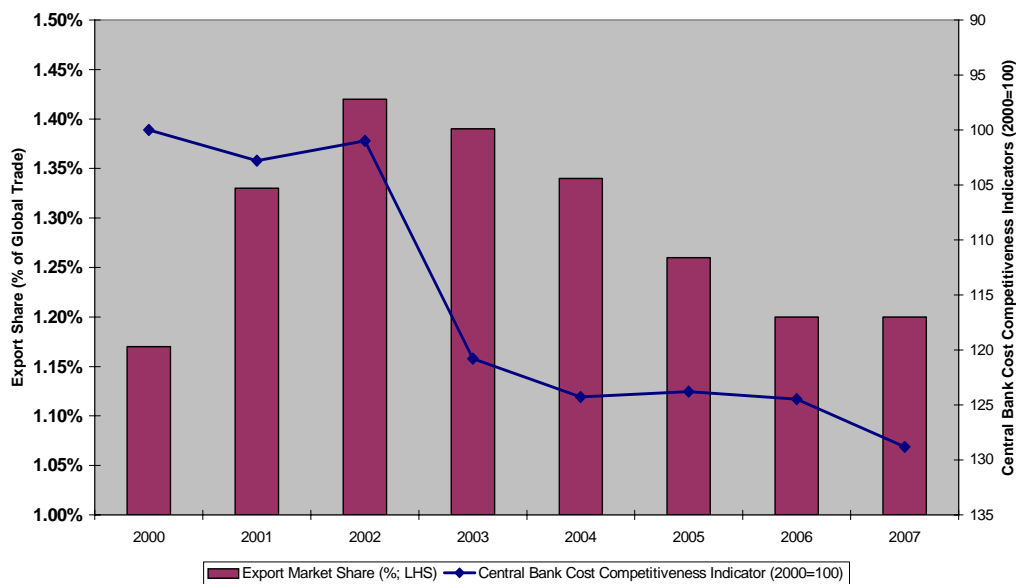
Competitiveness was what the Celtic Tiger was all about. Ireland used to be one of the best places in the world in which to invest and do business. We had low taxes, low costs, low inflation, a skilled and educated labour force and good public administration. For these reasons, multinationals chose Ireland as their exporting base.

But Irish competitiveness has been shattered by high cost inflation over the last eight years. While the rising euro has also played a part in our loss of competitiveness in recent years, it cannot explain why Ireland has been the country that has lost the most competitiveness of any in the euro area.

It is inflation in the sectors controlled or regulated by government which are the main drivers of Ireland's higher costs. Since 2000:

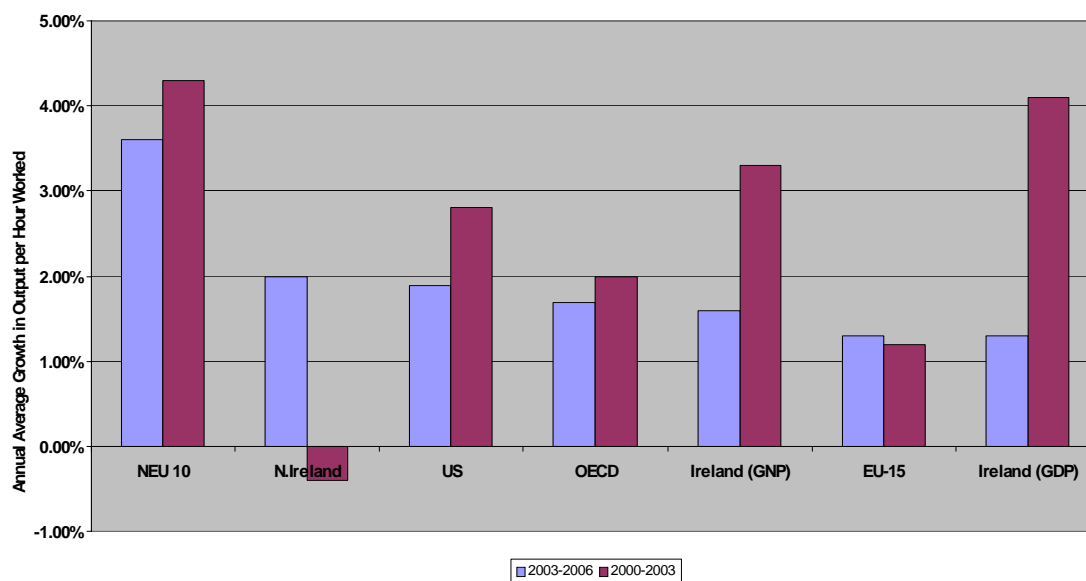
- The cost of local water supply, refuse collection and other miscellaneous services is up 129%
- The cost of electricity is up 65% since 2000
- The cost of building and construction is up 61%
- The cost of local authority rates is up 53%
- The cost of postal services is up 47%
- The cost of financial services is up 28%

**The Slow Death of Ireland's Competitiveness**



All the while, the underlying health and dynamism of the economy deteriorated. Between the beginning of 2001 and April 2007, Ireland's cost competitiveness against our trading partners has worsened by 35%, goods exports declined by 6% and manufacturing employment declined by 9% (27,000 jobs).

### The Collapse of Productivity



Good Government is an essential condition for rising productivity, which is the only long term basis for sustainable growth. It is hard not to be cynical about Brian Cowen's talk about his "strategic focus on raising productivity". It is his failures in planning and implementation by Government, and their botched management of strategic sectors and economic change programmes, that has undermined our global competitiveness and condemned Ireland to the second division in productivity growth.

- The knowledge economy has been held back by this Government's failure to break eircom's stranglehold on broadband outside of main cities / towns.
- Our climate change and energy competitiveness objectives have been frustrated by the Government's failure to loosen ESB's control of the electricity market.
- Our sustainable transport objectives by the Government's failure to break CIE's stranglehold on urban bus markets.
- A dysfunctional planning system led to contrived scarcity of development land made houses unaffordable and pushed development into unsustainable patterns locked into poor services and long commuting.
- An ill-planned decentralisation programme has convulsed the public service and delivered little.

### *Persistent Refusal to Accept FG Public Sector Reform Proposals*

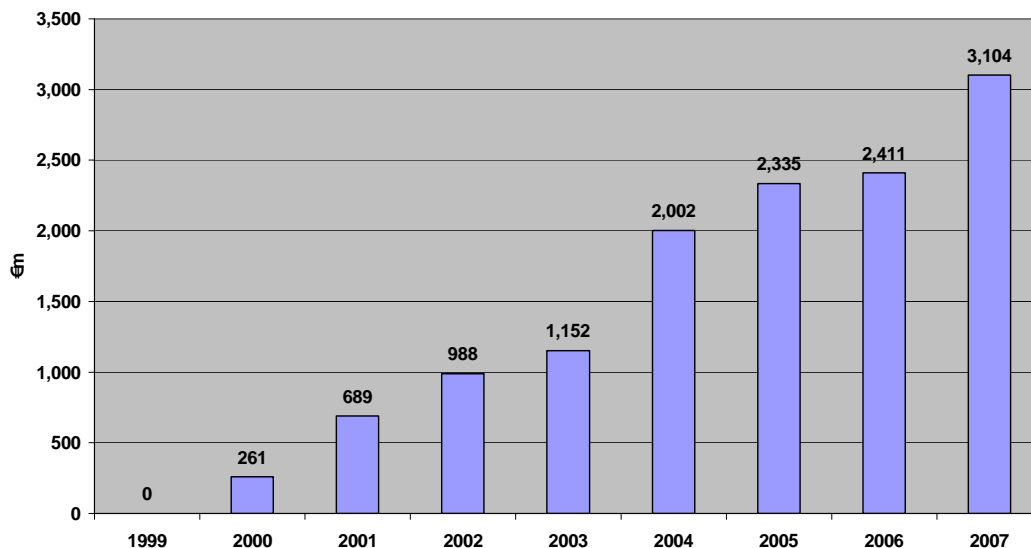
Fine Gael consistently warned this Government that its mismanagement would lead to disaster, but our warnings and calls for changes in policy were arrogantly ignored by an out-of-touch and reckless Government. Over the years, they dismissed our proposals that:

- the cost of public sector benchmarking should be paid for from real reform and productivity improvements, saving the taxpayer €1.2bn per year
- all Government Departments be subject to annual efficiency targets, potentially saving the tax-payer another €2 billion per year
- dubious capital projects be subject to published cost-benefit evaluations, avoiding the massive waste associated with projects like PPARS and eVoting
- Government stop creating new quangos and cut existing ones by at least 30, potentially saving the tax-payer at least €50m per year
- the C&AG be given a new mandate to improve public sector governance before money is misspent, which might have averted, for example, the €70m in wasteful spending by FÁS recently uncovered by Fine Gael
- The health bureaucracy be streamlined as part of the creation of the HSE, so that extra resources go instead to front-line services.

As a result, the CSO estimates that the rate of inflation in public services has been running at an annual average of over 6% since 2000 - 45% higher than the rate of cost inflation in the UK public sector.

If cost inflation in the Irish public sector had been kept down to the UK rate, we would have had an additional €3.0 billion for tax reforms or for front-line services such as education and health over the period 2000-2007 (enough to wipe out the net national debt), including an additional €3.2 billion in 2007 alone.

**Annual Exchequer Savings if Public Sector Cost Inflation Had Been Kept at UK Rates from 2000**



What has the UK Government done to lower public sector cost inflation and deliver real value-for-money improvements in public services that successive Fianna Fáil Governments have refused or failed to do?

- They have insisted that public sector managers target and measure efficiency gains for every Government Department (delivering a total €30 billion in efficiency gains between 2004 and June 2007). They are now targeting additional

efficiency gains of 3% per year by 2010/11, to release an additional €42 billion to front-line services). In contrast, the Government here has never required Departments here to measure or deliver specified efficiency gains.

- They have cut the number of civil service administrative posts by 79,716 (a cut of about 16%) through technology-driven automation, with a high proportion of these posts being re-allocated to front-line services in education, health and policing. In contrast, Irish civil services numbers continue to rise. If the Irish Government had shown a comparable level of ambition, we would have 6,000 fewer civil servants – posts that could then be re-allocated to provide extra front-line services in health, education and policing at no extra cost to the tax-payer.
- They introduced three-year budgets for all spending departments to enable longer-term planning. UK Departments are also given full end-year flexibility to carry forward any under-spends from one year to the next to prevent wasteful end-year surges in spending. In contrast, Irish public sector managers still face a “spend it or lose it” choice at the end of each year.
- They introduced a new Resource Accounting and Budgeting system to capture accurately the full cost of running public services, including the value of assets, and to sharpen management incentives. In contrast, Irish public sector managers still do not account for the value or use of assets under their control.
- They introduced systematic, transparent, outcome-focused performance management system for public services, in the form of Public Service Agreements between the UK Treasury and the line spending departments. In contrast, this Government has only this year introduced Annual Output Statements by Departments, few of which contain any concrete targets for efficiency or performance linked to resource allocation in the budget.

In short, successive Fianna Fáil Governments, spoiled by the property taxes that rolled in from the debt-driven housing boom, avoided the hard decisions and new approaches by the UK Government.

Instead of reform, we have had soft-option politics, throwing money at problems to poor effect. The Government has been responsible for weak strategic planning, for botched reform of critical sectors, for poor anticipation of global challenges, and for the abandonment of good spending habits built up during more than a decade under the influence of the Tallaght Strategy.

### ***The Government Has Floundered in the Face of the Crisis***

The Government’s package of cutbacks announced in July has been judged as a feeble and hopelessly inadequate effort to restore confidence by a Minister for Finance who is clearly out of his depth. There was no forensic search for waste and poor value for money. No major reforms to deliver better value for money or open up new sectors of the economy to competition, investment and job creation. No vision. No plan.

The contrast with the sense of urgency in other countries is stark. As the Taoiseach and his colleagues went on holidays, the Spanish Prime Minister recalled his Cabinet from theirs to agree an economic stimulus and reform package, involving:

- A €10bn boost in infrastructure spending
- A one-off €400 tax rebate for all wage earners to boost consumption
- A €6bn VAT rebate and a cut in corporation taxes
- A freeze in pay for senior public servants
- Part privatisation of the country's sea- and air-ports
- Liberalisation of the professions and rail services

Similar stimulus and reform packages have been announced already in Sweden, France, Denmark and the UK. While none of these economies will escape economic difficulties, none are expected to suffer from the scale of Ireland's reversal.

The State guarantee for the liabilities of banks was unavoidable, but has done nothing to address the underlying problems of bad debt, the loss of national competitiveness and the black hole in the public finances.

The Government has upgraded the "storm warning", but there is still no clear economic strategy

***Without Action, the National Debt Will Double by 2011***

The pace and scale of the deterioration in the public finances is the most alarming element of our weakening economic performance.

**Likely Evolution of Government Finances Without Action**

	Current Balance (€m)	EBR (€m)	GGB (% of GDP)	National Debt (€)
2007	+7,060	-1,623	0.5%	37,559
2008	-1,897	-11,595	-5.3%	49,154
2009	-5,187	-15,038	-6.8%	64,192
2010	-5,530	-15,481	-6.8%	79,673

According to the latest estimates:

- Government borrowing will be 5 times more than projected by Brian Cowen on Budget Day.
- We will be almost twice above the maximum level of Government borrowing allowed for by the rules of Economic and Monetary Union.
- In sharp contrast to Brian Cowen's election promise to make Ireland debt free, the National Debt is now on course to double by 2010.
- For the first time in 12 years the Government is borrowing money to fund day-to-day spending, instead of following the golden rule of borrowing only for capital purposes. In an unfortunate repeat of history, we are once again borrowing from our children to pay for the waste and extravagance of a Fianna Fáil Government.

### **3. What Would Fine Gael Do?**

The Irish people are now exposed to a very dangerous situation. So far the Government's only response has been to prune back on capital spending and apply a uniform cut to all wage bills outside the Health and Education sector. There has been no strategic re-think of how Government delivers services efficiently and effectively, no forensic search for waste, no imaginative ideas about how to create jobs through new sources of competitive advantage for Ireland.

The Budget presents an opportunity for this Government to acknowledge mistakes of the past and set a new course for Irish public services and the economy that helps to restore consumer and business confidence.

This opportunity cannot be wasted. Further mistakes by Government now would irreparably damage confidence and threaten to turn the recession into a prolonged depression.

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#### ***1. Avoiding the Soft Options***

- **Don't cut overall level of capital spending**

Mr Cowen recently indicated that NDP projects may now have to be scaled back because of the weak state of the public finances. In other words, the failure by Brian Cowen to control day to day current spending and to get value for money from taxpayers' money is now putting at risk the investment in infrastructure that is needed to get the country back on track and secure future prosperity.

This is a humiliating political climb-down for Brian Cowen who always insisted that the NDP was his top political priority. In his Budget speech last December he said: "Postponing or delaying [the NDP] would be a major policy error. I am determined to roll it out as planned."

It is also entirely the wrong approach. Now is not the right time economically to be cutting back on the capital spending needed to improve our competitiveness and develop the skills needed for the knowledge economy, such as technology in our

schools. Unlike Mr Cowen, we see the downturn as an opportunity to accelerate investment in affordable housing, energy, broadband, schools, hospitals and transport.

○ **Don't raise tax rates on employment, investment, capital or consumption**

It is not fair or wise to raise taxes in response to this Government's failure to control spending or manage the economy. More than any other time in our recent history, we need to maintain incentives for entrepreneurs and investors to create jobs and for work to pay.

Another round of stealth taxes and charges on consumers and businesses would also be the wrong course of action. Ireland is already the most expensive country in the eurozone to live or do business, in large part because of the inefficiencies of the public sector. We need to reduce the cost of living in Ireland, not increase it.

○ **Don't waste money bailing out developers**

Lower land prices are a necessary adjustment in the economy. The Government should not be panicked into short-term measures to support the housing market. There is a clear consensus that Irish house prices have further to fall before they return to fair values. Encouraging low income households to borrow extra money from the state to buy into a rapidly falling property market would be a serious policy mistake at this time. It will only serve to delay a badly needed correction in the housing market, and lumber vulnerable households with unnecessary levels of debt.

○ **Don't stop preparing for an ageing population**

The Government would be making a major blunder if it plans to legislate to cut off contributions to the National Pensions Reserve Fund. This would fly in the face of everything successive Irish finance ministers have espoused, suggesting to the world that all long-term principles of Irish fiscal policy will be dropped by this Finance Minister at the first sign of economic trouble.

In accounting terms it would make no difference to EU budgetary commitments. Payments into the fund, while adding to the Exchequer borrowing requirement, do not count as General Government Expenditure under EU definitions and suspending the payments, therefore, would not help us to get back within the 3% borrowing limit.

It displays a serious misunderstanding of the threat posed to the State from unfunded pension liabilities. The Fund was established to help meet the future cost of social welfare and public sector pensions as the population ages. While the value of the fund was €19.4 billion at the end of June, the value of public sector pension liabilities alone was €75 billion at the end of 2007.

Indeed, the last Government's recruitment of 40,000 extra public servants, together with his ill-judged benchmarking pay awards, will add about €1 billion in extra pension costs every year (at today's prices), for which proper financial management requires an annual set-aside of money.

Moreover, the Fund's investment strategy relies on a continuous stream of funding. Suspending payments would undermine the Fund's long-term investment strategy and ignores the lucrative investment opportunities that are now opening up to sovereign wealth funds around the world.

Instead of suspending contributions, a more thoughtful way for the NPRF to take pressure off the public finances is for the Government to create more commercial opportunities for investment in Ireland by the NPRF in Ireland, particularly in the areas of broadband, energy, transport and social housing.

Similarly, it would be a big mistake to use the proposed transfer of pension assets and liabilities of non-commercial semi-state agencies into the state sector as a way to take pressure off the need to control spending. The assets of these pension funds should be invested through the NPRF and should not be counted as Government revenues.

## ***2. “Tough but Fair” Measures to Stabilise Borrowing***

Fine Gael believes that it is important to signal to consumers and investors that the Government has regained control of its public finances by reducing the level of borrowing in 2009 compared with the €1.5 billion exchequer borrowing requirements this year. This requires corrective measures of at least €4.5 billion. In Fine Gael's view, the fairest way to make these adjustments is as follows:

- **Freezing in voted exchequer current spending in 2009 at 2008 levels (a €1.8bn cut from previously planned spending levels)**
- **Finding 3% savings in every other department (compared with 2008)**

This is needed to pay for extra the €1 billion that will be required for the higher social welfare bill (including indexation). Among the sources of these savings should be:

- A pay freeze, including length of service increments, for those earning more than €50k
  - A recruitment freeze outside of front-line services
  - A reduction in the number of quangos by at least 30
  - A significant cut in the budget for the HSE's drugs payment scheme, by allowing pharmacists to make generic substitutions for branded drugs
- **A fair charge on banks for the guarantee (€1.5bn p.a.)**

The Irish taxpayer should be fairly compensated for guaranteeing the liabilities of all the main retail banks in Ireland, which reduces their funding costs and increases their profitability. A fair charge would be 0.5% per annum on the banks' wholesale deposits and loans and 0.25% on the banks' retail deposits. This would also serve to encourage banks to return to more stable forms of banking where retail deposits account for a high proportion of the banks' funding. Depending on the number of banks covered by the scheme, this should raise at least €1.5 billion per year. If shortages of capital mean that the banks have difficulty in making these payments, then the Government should take a payment in kind in the form of preference shares.

- **Replacing Exchequer Capital Spending with PPP Financing from the NPRF (€1 billion)**

Many of the infrastructure projects that are currently promised exchequer financing could easily be financed on a commercial Public Private Partnership basis, with much of the funding coming from the National Pensions Reserve Fund, thereby taking the pressure of the exchequer finances and Ireland's EU borrowing limits. It is also possible that this method of financing could achieve greater cost efficiencies in the delivery of the projects.

Priority areas for the preparation by the Department of Finance of commercial investment opportunities for the NPRF should include: the electricity inter-connector with the UK, Next Generation Broadband, Metro North and social housing.

- **A carbon windfall levy on power generators (€300m p.a.)**

Irish electricity prices are currently about 10% higher than they would otherwise be because power generators charge consumers for the price of the carbon emissions they produce when producing electricity, even though they have not had to pay the Government anything for their emissions rights. At the current market price for carbon, Irish power generators stand to make a windfall gain of around €300m per year as a result of this gift from the Government (paid for out of consumers' pockets). As the public finances deteriorate, it is time to end this rip-off through a special levy to recover this windfall gain on behalf of the taxpayer.

- **An end to decentralisation (€100m p.a.)**

Too much money (€500m) has already been committed to a badly designed and implemented decentralisation programme. While decentralisation of Government administrative services out of the capital is right in principle, it should never have involved policy making Government Departments or agencies requiring highly specialised skills. Moreover, it should also have been aligned to the National Spatial Strategy in order to be a real driver for regional development. It is time to take this decentralisation programme off life support, saving the €400m allocated to it under the National Development Plan that has not yet been committed.

### ***3. Make the Reforms Needed to Root Out Waste***

As well as the immediate measures needed to reduce borrowing next year, we also need to see the start of a longer-term programme of structural change to improve the way Government manages the public finances and public services.

A credible programme of this nature is necessary to give investors and taxpayers the confidence that taxes in Ireland can remain competitive even while services and infrastructure are improved.

#### ○ **“A Better Budgeting Act”**

In order to raise confidence that this Government’s mistakes over the last five years will not be repeated, it should commit to new budget legislation that:

- Sets new fiscal rules to end the boom-bust economic management of the last five years. These rules should include a limit on Government borrowing to the level of capital spending over the economic cycle (the “Golden Rule”. It should also require that the presentation to the Oireachtas in advance of each budget of a joint report by the Central Bank and the Department of Finance stating the appropriate budgetary balance in the following years given Ireland’s position in the economic cycle.
- Requires that the Department of Finance present an annual report to Oireachtas in advance of each budget on public finance sustainability, including the implications of pensions commitments by Governments for future tax levels.
- Ends the “Existing Level of Service” basis for preparing budgets, which locks into future years all the existing waste and inefficiency. Instead, we should move to a New Zealand type budgeting system, where budgets for each department are steadily reduced (e.g. by 2% per year) to free up resources for new programmes.
- Integrates the performance measurement and annual budgeting process for each department i.e. annual output and outcome statements should be prepared by each department in advance of the annual budget.
- Requires published cost-benefit analysis for all major capital spending projects to expose dubious projects
- Gives new ex-ante powers for the Comptroller and Auditor General to improve the corporate governance and financial management of agencies and departments in order to root out waste and inefficiency

#### ***4. Protect the Vulnerable and Help the Unemployed***

##### ○ **Index social welfare payments**

With the additional numbers in receipt of social welfare payments, we estimate that this will cost c.€1,000m in additional exchequer spending (as well as €1,000m in higher benefit payments from the social insurance fund).

##### ○ **Double emergency support for debt-distressed home-owners to €30m**

Between the end of 2007 and earlier this month, the numbers of people in receipt of Supplementary Welfare Allowances to help them with their mortgage payments increases by 50% to just over 6,000. As unemployment soars, we anticipate that an additional 6,000 distressed families will likely need help in keeping up their mortgages payments on their homes while they look for alternative work. The additional funds should be disbursed both through the Money Advice and Budgeting Service (MABS) and Community Welfare Officers.

- **Increase the winter fuel allowance by 50% to €27 per week (€65m)**

Ireland has among the highest energy prices in the EU, added to by the recent rise of 17.5% (Aug 2008) in electricity costs and a 20% rise in gas prices (Sept 2008). The price of heating oil rose by 78% in the past 12 months. In addition the Commission for Energy Regulation is actively considering further electricity and gas price increases for January 2009. In 2006 the average annual spend on energy by households was €1,767, an increase of 4% on 2005 and 70% on 1990. The rise in energy prices was not met by similar increases in the fuel allowance, therefore low income households are forced to enter into debt to pay energy bills.

- **Extend Back to Education Allowance (€70m)**

With over 300,000 people expected to be on the Live Register in 2009, it is to change the rules governing the Back to Education Allowance (BTEA). To claim the BTEA a person has to be claiming social welfare payments, such as Job Seekers' Allowance, for a full 12 months beforehand. In other words, they are disqualified from claiming BTEA if they worked for the year before going back to college, no matter what their income level.

This makes no sense in terms of reducing the cost of State payments as those on the minimum wage are denied the BTEA while those who are receiving a variety of State payments are able claim it. There is only €1 a week difference in income between those on the minimum wage and those in receipt of Jobseeker's Allowance, Rent Supplement and medical card benefits.

It would make far more sense in the current climate to facilitate those who wish to return to third level in the hope of increasing their skill levels and employment prospects instead of being forced to drop out or stay out of employment and claim Job Seekers' Allowance in order to be eligible for the BTEA.

By doubling the budget for the Back to Education Allowance and extending its availability to the short-term unemployed and those earning less than €12 per hour, the numbers taking up the opportunity to return to education could be increased by 6,000.

## ***5. Creating Jobs in a Smarter Economy***

Finally, it is important for the budget to set out a path and strategy for reinventing Ireland's economic success and competitiveness, now that Brian Cowen's debt-driven property boom has been exposed as a dangerous and unstable source of employment, growth and resources for the public sector.

- ***Break down the barriers to "green collar" employment***

The Government should remove the barriers that are hampering the potential for a huge increase in "green collar" employment – skilled jobs in renewable energy and energy saving technologies.

As an immediate start, the Government must open up access for renewable (wind wave) power and micro-generation to the electricity grid. Such sources of power have the potential to create hundreds of millions in export earnings and thousands of highly skilled jobs, particularly in regional locations. But ESB's continued ownership of the electricity network while also competing in the power generation market is a barrier to investment from new entrants into the market. We should move ownership of the grid to eirgrid, the network operator.

Another barrier is the slow progress in delivering the promised electricity inter-connectors with the UK, which is necessary to bring more renewable sources of power onto the Irish grid. This should become a top national infrastructure priority, with financing coming from the NPRF. And we should also immediately planning a further direct inter-connector with continental Europe.

From 2009, all existing as well as new houses and commercial buildings coming onto the market for sale or rent will require a Building Energy Ratings, setting out the building's energy efficiency level. This has the potential to create thousands of new jobs both certifying and improving the energy performance of our building and housing stock.

However, a number of bureaucratic barriers stand in the way of new employment creation in this area:

- Slow progress by Sustainable Energy Ireland in expanding their certification and accreditation programme for building energy raters (usually architects and other skilled professionals).
- Slow progress by FAS in putting in place retraining programmes in the area of home energy efficiency improvements for the thousands of skilled construction professions that have been laid off from the house building industry.

- ***A Knowledge Economy and Job Creation Package***

The budget should also support more innovation and employment creation, particularly by small businesses. A number of measures and commitments are important in this regard:

- Switch the R&D tax credit to a “volume based” approach to allow Ireland to compete with other countries (the UK, Spain) in attractive research intensive mobile foreign investment projects.
- Allow start-ups to offset R&D tax credit against PRSI. Many high-tech start-ups do not get the benefit of the R&D tax credit because they do not earn profits for many years (if at all). Allowing start-up companies to offset the R&D tax credit against their employers' PRSI liability would provide a significant boost to knowledge-economy entrepreneurship in Ireland at a time when risk capital is becoming harder to come by.

- Give SMEs a PRSI offset to support employee upskilling. As with spending on research and development, small companies should also get a PRSI offset for a proportion of their spending on employee upskilling (in certified courses and colleges).
- Cut the red tape burden that is strangling entrepreneurs. As set out by the Better Regulation Forum, cutting the information obligations imposed on small businesses through smarter regulation and enforcement could save hundreds of millions of euro, as well as improving the efficiency and effectiveness of the public sector. The Budget should set aside the resources necessary to expedite a red tape measurement and reduction programme, with a 25% reduction target to be achieved in two years.