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SM/83/126
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

July 20, 1983

To: Members of the Executive Board
From: The Acting Secretary
Subject: Ireland - Staff Report for the 1983 Article IV Consultation

The following corrections have been made in SM/83/126 (6/14/83):

Page 8, tabulation, line 2: for "11, 3 1/2, --" read "13 1/2, 6 1/2, 2 3/4"

para. following tabulation, line 4: for "12 per cent"
read "15 per cent"

Page 13, 2nd full para., line 3: for "80 per cent" read "70 per cent"

Pages 17, 19, and 21: Figures in Tables 1, 3, and 5 corrected

Pages 4b and 4g: Charts 4 and 9 have been changed to reflect corrections
of figures in tables.

Corrected pages are attached.

Att: (7)

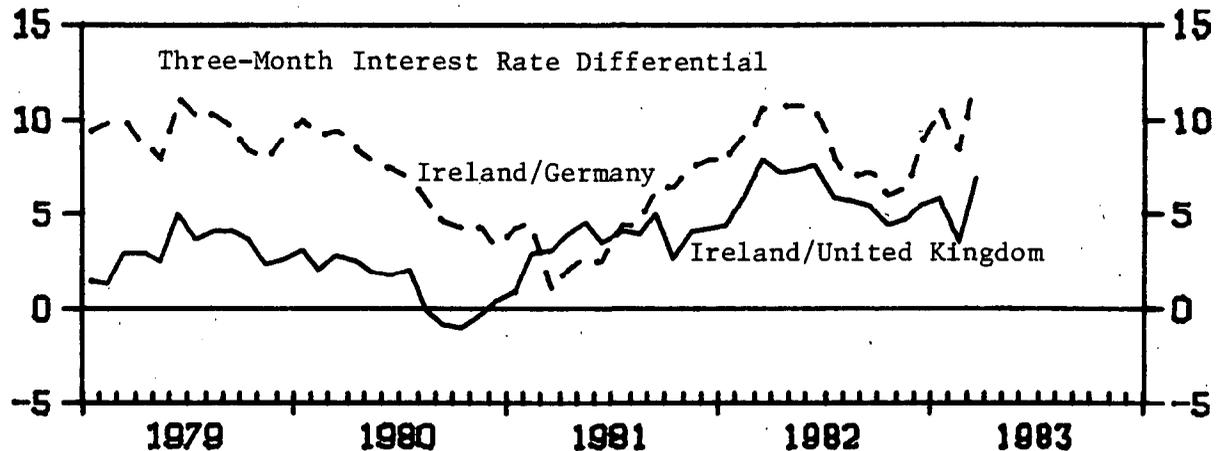
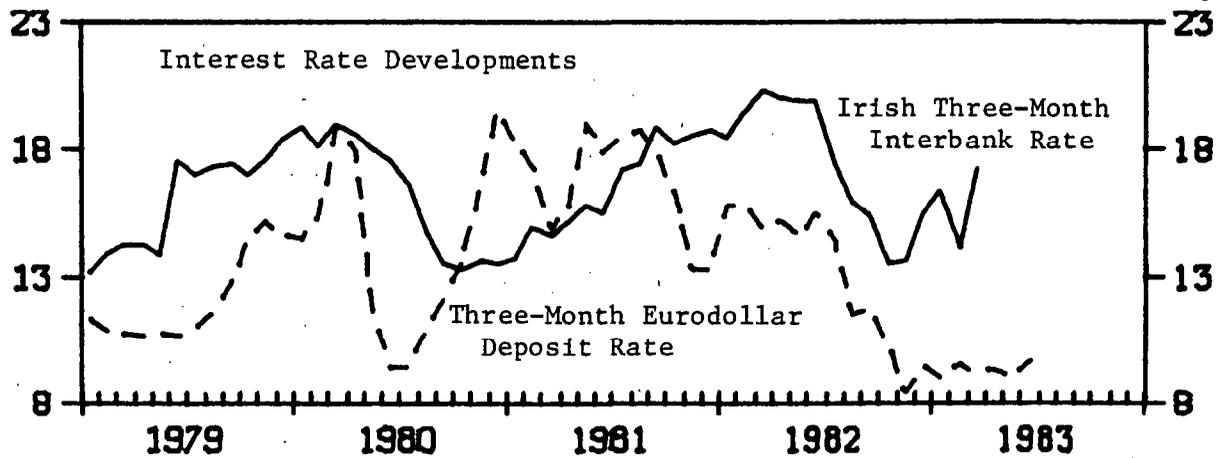
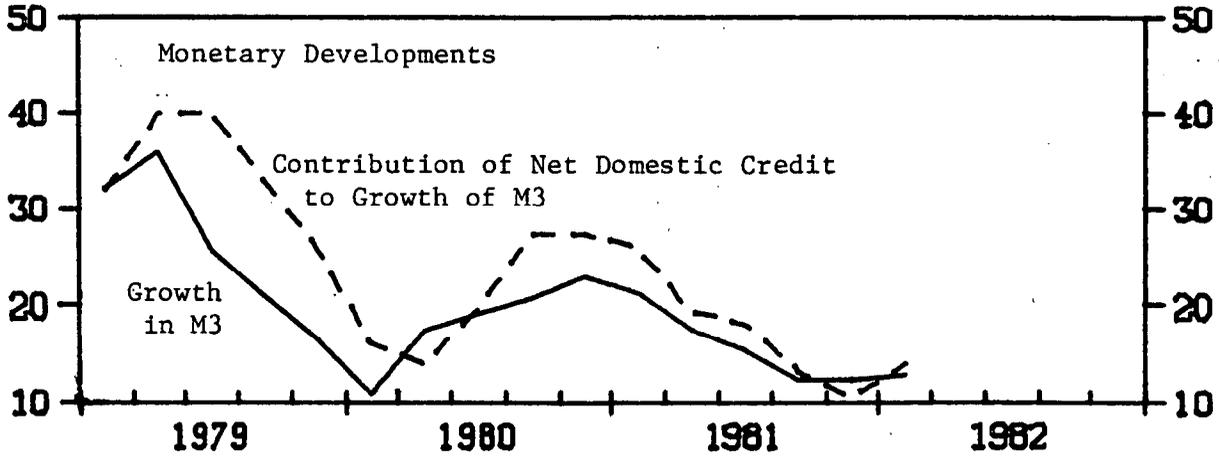
Other Distribution:
Department Heads

CHART 4

IRELAND

MONETARY AND INTEREST RATE DEVELOPMENTS

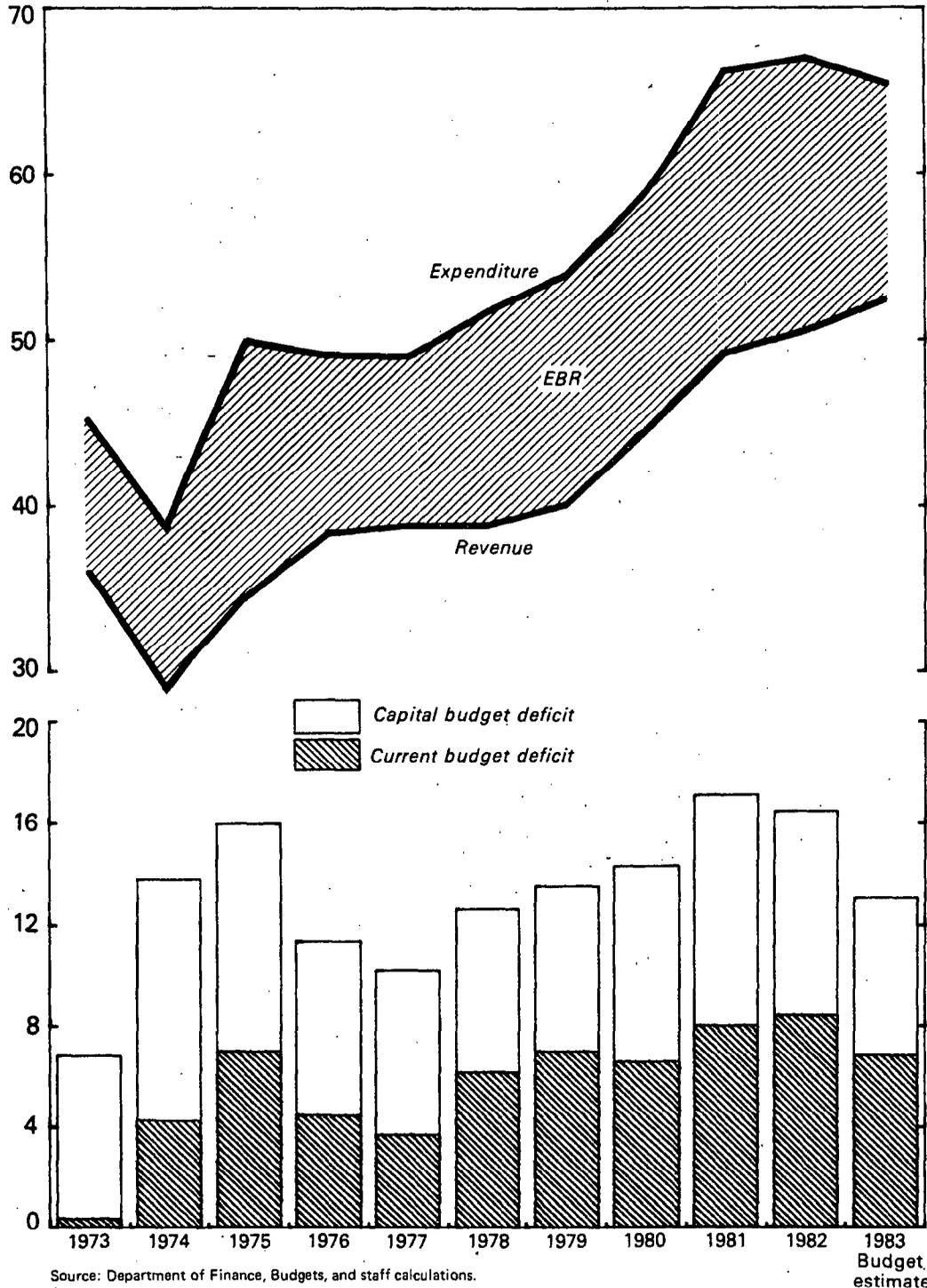
(In per cent)



Sources: Central Bank of Ireland, Quarterly Bulletin; and IMF, International Financial Statistics.

CHART 9
IRELAND

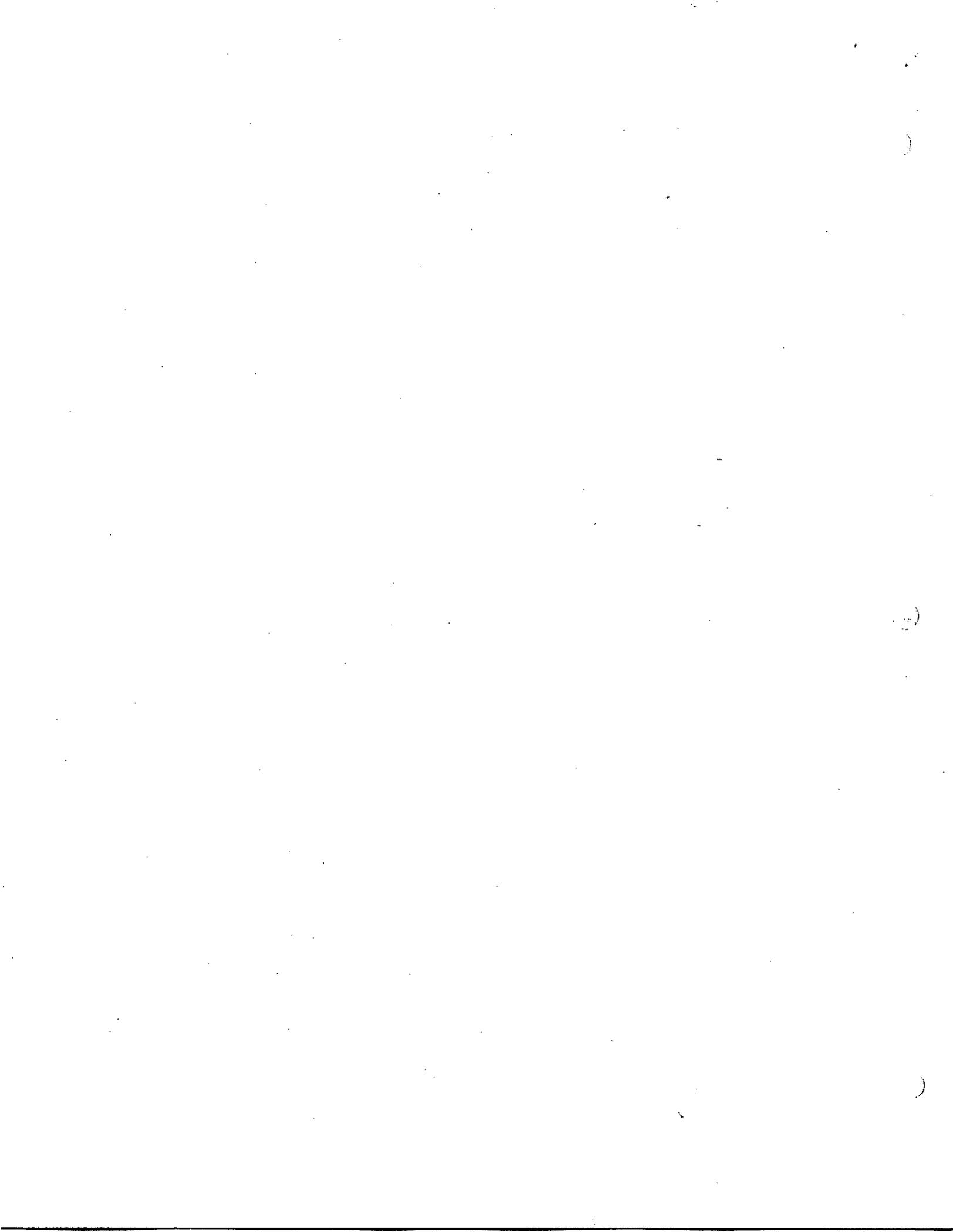
CENTRAL GOVERNMENT: EXPENDITURE, REVENUE
AND EXCHEQUER BORROWING REQUIREMENT¹, 1973-83
(Per cent of GNP)



Source: Department of Finance, Budgets, and staff calculations.

¹The year 1973 is a fiscal year (April/March), 1974 covers April to December, and the following years equal calendar years.

Budget estimate



As already noted, the authorities have recently introduced strong measures to arrest and gradually reverse the deterioration in the public finances. Apart from the steps taken to curb the growth in expenditure, control procedures have been tightened in order to resolve the recurrent problem of substantial overruns of budgetary appropriations and in 1982, for the first time in many years, spending was kept below the initial estimates. Nevertheless, the main burden of fiscal adjustment has fallen on taxpayers. Government revenue as a proportion of GNP has risen to 42 per cent in 1982 and a prospective 43 1/2 per cent in 1983, compared with 39 1/2 per cent in 1981 and about 30 per cent in the mid-1970s. Taxation policy may have contributed to the recovery of the national savings ratio in 1982 (to 19 per cent from a ten-year low of 15 1/2 per cent in 1981), which in turn accounted for about 60 per cent of the improvement in the external current position. However, it has also exacerbated the recessionary conditions in the economy which, together with the increase in interest payments on the national debt, tended to obscure the strengthening of the underlying budgetary position. As a ratio to GNP, the EBR fell only slightly in 1982 to 16 1/2 per cent, although it is expected to decline sharply in 1983 to 13 per cent.

The authorities' objective is to eliminate the current budget deficit by 1987. In so doing their general approach will be to rely more on expenditure reductions than on tax increases. While a further significant rise in the overall tax burden is viewed as undesirable, there is considerable room for improvements in the tax system and in tax administration. A problem of particular concern is the unusually high share of direct taxes borne by the PAYE sector (about 75 per cent of the total in 1982) reflecting the low taxation of property and other wealth, tax evasion by the self-employed, and the wide range of tax reliefs granted to the business and farming sectors to promote economic development. Some measures to alleviate this problem, including the abolition of some tax reliefs and the extension of income tax to all farmers, were taken in the 1983 budget. In addition, stiff penalties for tax evasion and other measures to improve tax collection are being introduced. However, the authorities have decided that, for the time being at least, the more far-reaching recommendations of the Commission on Taxation--which called for a single, relatively low rate of taxation on all personal and corporate incomes--could not be implemented as they would involve a significant loss of government revenue. Another important limitation of the present system is the narrow base of indirect taxation. In part, this is related to the fact that about 30 per cent of consumer spending is not subject to VAT. By contrast, the tax rates for items that are subject to VAT are very high (the standard rate is 35 per cent) tending to encourage spending across the border with Northern Ireland and the growth of the underground economy. At present, no action in this area is envisaged pending the submission of a detailed report on the indirect tax system by the Commission on Taxation.

The authorities have already announced that expenditure adjustments will be the primary focus of the budget in 1984. Although specific decisions have yet to be made, it is recognized that expenditure restraint

will have to be extended beyond pay and employment in the public sector. The areas of expenditure that are considered likely to be affected, either directly or through increased charges, include the provision of certain public services, in particular health and tertiary education, food subsidies, and perhaps also income maintenance payments, which have increased by over a third since 1978 in relation to average take-home pay. In addition, increased attention is being paid to the need to improve the efficiency and financial position of public enterprises and the need to rationalize the capital expenditure program.

The scale of the adjustments in public spending that will be required to phase out the current budget deficit by 1987 will be determined in the light of the official medium-term economic program, which is currently under preparation. Nevertheless, work at the technical level has already been carried out to identify the main parameters of the problem. The results of this work underscore the difficulty of the task that the authorities are faced with, but also the significance of satisfactory economic growth in making this task more manageable. It is considered likely that Central Fund expenditures (consisting largely of interest payments on the national debt) will stabilize at about 12 per cent of GNP provided that the budget deficit is indeed phased out at a steady pace over the period and that interest rates fall gradually as progress is made in lowering inflation. If current government revenue were to remain stable in terms of GNP at about the present level of 44 per cent, the decline in the volume of other public spending that would be required to restore current budget balance by 1987 would depend crucially on the rate of growth in GNP, as shown below:

	<u>In per cent</u>		
Average rate of growth of real GNP in 1984-87	1	3	4
Required cumulative decline in volume of discretionary spending from 1983 to 1987	13 1/2	6 1/2	2 3/4

If budgetary equilibrium were to be sought at a reduced burden of taxation, the necessary decline in public spending would obviously be higher. For example, if current revenue were to fall to 40 per cent of GNP by 1987, a 15 per cent volume reduction in the supply of noncapital services would be necessary to balance the budget, even if GNP were to grow by as much as 4 per cent per annum, on average.

2. Competitiveness

International competitiveness, as measured by trends in relative unit labor costs in manufacturing, has generally tended to strengthen since the mid-1970s (Chart 10). 1/ Up to 1981, this was the result of

1/ Wholesale prices and export unit values of manufactures have also tended to decline relative to the weighted average of trade partner countries, although less markedly than relative unit labor costs.

becoming expansionary. Nevertheless, improved methods of official intervention in the money market are being envisaged. In the past, foreign exchange swaps with the banks were the principal instrument used for smoothing the intermittent large swings in domestic liquidity conditions, but there has been growing awareness of the disadvantages of overreliance on this instrument at times of unsettled conditions in the exchange market. Accordingly, the authorities are actively considering making increased use of other instruments of liquidity management and are continuing their progress in developing a secondary market for government securities.

4. Other policy issues

As a member of the European Communities, Ireland no longer operates an autonomous foreign trade policy. The Irish representatives indicated that no major changes had occurred under the EC common commercial policy since the last Article IV consultation, except for the renewal of the Multifiber Agreement and the implementation of surveillance on imports from Japan; this requires EC member states to monitor developments in the volume and value of imports from Japan of some 12 groups of goods. In 1982 the authorities had also decided to charge VAT on imports at the time of entry rather than at the time of sale; this measure had been motivated by tax policy considerations rather than trade policy objectives. The authorities recognized the problems that the measure had caused for business, but could not dismantle the new system; however, in the 1983 budget, imports of raw materials and components by firms that export 75 per cent or more of their output were exempted from the payment of VAT.

With respect to the effects on Ireland of restrictive practices by other countries, the Irish representatives indicated that, although as much as 70 per cent of its trade was with EC partners and thus free of formal restrictions, there was concern that the dispute between the U.S. Government and the EC Commission on trade in agricultural products could have repercussions on Irish exports.

Ireland's official development assistance (ODA) in 1982 amounted to 0.22 per cent of GNP, remaining well below the UN target of 0.7 per cent. The allocation for 1983, despite the stringent economic situation, was increased by £Ir 4.4 million to £Ir 30.1 million (0.23 per cent of estimated GNP). Of the total allocated in 1983, some 35 per cent was bilateral aid. The Government's medium-term objective is to increase development aid by 0.05 per cent of GNP each year until the UN target is reached.

Ireland relies heavily on imported energy resources, which currently account for approximately 73 per cent of total domestic energy requirements, compared with 78 per cent in 1980 and 82 per cent in 1978. The Irish representatives noted that the 1979/80 oil price increase had been fully reflected in domestic energy prices and this had contributed to a fall in consumption of petroleum products. In addition, there had been a significant shift away from oil usage and greater exploitation of indigenous energy resources, notably natural gas. The share of the latter in

total energy usage had increased to 11 per cent in 1981 from 6 per cent in 1980; it was expected to approach 20 per cent in 1985 before falling back to 14 per cent in 1987 as supplies were depleted. Therefore, additional conservation efforts were being considered. Opportunities for reducing Ireland's dependence on imported energy lie with the increased reticulation of natural gas for direct consumption and greater exploitation of peat and coal reserves.

V. Staff Appraisal

Over the last two years, the Irish authorities have introduced belated but strong and courageous policies aimed at redressing the severe internal and external imbalances that had previously emerged. These policies have achieved a notable degree of success in terms of a rapid decline in the balance of payments deficit on current account and a significant deceleration in the underlying rate of inflation. They have also helped reverse the excessive gains in real wage incomes that had been experienced in the late 1970s. It is noteworthy that the broad thrust of the adjustment policies has been maintained by three successive governments despite the generally unsatisfactory external and domestic economic environment. It is also encouraging that the need for adjustment has found increasing popular acceptance. Nevertheless, the moderation of nominal pay increases has been less pronounced than, on average, in Ireland's main trade partners, and it seems that at least in some parts of Irish industry cost-price relativities have not yet been fully restored to a level compatible with the maintenance of employment levels. In view of this and the deepening recession, labor shedding has occurred on a sizable scale, contributing to a rapid rise in unemployment.

The improvement in the external current account position is likely to continue in 1983, with the deficit probably falling to the equivalent of some 3 1/2 per cent of GNP as against 14 per cent of GNP only two years ago. While this progress is certainly impressive, it is important to note that the fall in the deficit is expected to come about partly as a result of cyclical developments, including in particular the prospective further increase in unemployment. For this reason, it is unlikely to prove fully sustainable in the absence of further corrective action. The staff therefore agrees with the authorities that policies in the period ahead should continue to aim at consolidating the improvements in the balance of payments position while, at the same time, restoring conditions conducive to adequate growth in output and employment. Essential ingredients for the attainment of these aims are a further correction of relative factor prices in the economy and a continued phased but sizable reduction in the EBR.

Considerable action has already been taken to restore order to the public finances, although because of the recession the results have only partly become apparent in the budgetary accounts. However, while progress has been made in curbing the growth in public expenditure and improving control procedures, the brunt of the fiscal adjustment has so far been borne on the taxation side. This may have contributed to a

Table 1. Ireland: Expenditure on GNP

(Changes in per cent)

	<u>1976-79</u> Average <u>1/</u>	1980	1981	1982	1983 <u>2/</u>
GNP at current market prices	18.2	16.6	18.1	16.7	11.2
GNP deflator	14.1	14.0	17.7	17.0	11.2
Real GNP	3.6	2.3	0.3	-0.3	--
Real GNP adjusted for changes in the terms of trade <u>3/</u>	3.5	-1.5	-1.1	1.7	0.8
Components of demand at constant prices					
Private consumption	4.7	0.2	-0.4	-5.5	-2.0
Public consumption	4.9	6.1	--	3.3	0.5
Gross fixed investment	11.0	-6.9	5.5	-7.5	-9.0
Stockbuilding <u>4/</u>	...	<u>-2.9</u>	<u>0.2</u>	<u>1.5</u>	<u>-0.6</u>
Total domestic demand	6.9	-3.2	1.2	-3.0	-3.8
Exports of goods and services	10.3	6.4	1.6	4.5	7.2
Imports of goods and services	<u>14.4</u>	<u>-4.2</u>	<u>1.7</u>	<u>-4.0</u>	<u>-0.5</u>
Foreign balance <u>4/</u>	...	6.6	-0.2	5.3	4.3
GDP	4.3	2.7	1.1	1.5	0.5
Net factor income from abroad <u>4/</u>	...	-0.5	-0.9	-2.0	-0.5
Memorandum items:					
Consumer prices	13.0	18.2	20.4	17.1	11.0
Real personal disposable income	4.3	-3.7	-2.0	-1.1	-3.0
Real net farm income	-1.1	-22.2	-5.2	2.4	...
Nonagricultural wage bill	19.7	22.3	16.7	13.2	...
Profits <u>5/</u>	22.6	4.0	15.2	20.0	<u>6/</u> ...
Manufacturing production	7.9	-1.9	2.4	0.1	1.5
Average weekly earnings in manufacturing	15.8	18.2	16.7	13.3	9.7
Output per manhour in manufacturing	5.1	1.4	5.9	5.5	5.0
Unit wage costs in manufacturing	10.3	19.5	9.8	8.5	4.5

Sources: Department of Finance, Economic Review and Outlook; Central Statistical Office, National Income and Expenditure, 1980; Central Bank of Ireland, Quarterly Bulletin; IMF, International Financial Statistics; and data provided by the Irish authorities.

1/ Compound annual average.

2/ Forecast.

3/ By deflating exports of goods and services by the deflator of imports of goods and services.

4/ Contribution to growth in GNP.

5/ Trading profits, professional earnings, interest, dividends, and rents before adjustment for stock appreciation.

6/ Estimate.

Table 2. Ireland: Balance of Payments Summary

	1978	1979	1980	1981	1982	1983 ^{1/}
(In millions of Irish pounds)						
Merchandise exports, f.o.b.	2,922	3,395	4,004	4,787	5,621	6,480
Merchandise imports, c.i.f.	-3,656	-4,760	-5,346	-6,484	-6,719	-7,015
Trade balance	-735	-1,365	-1,342	-1,697	-1,098	-535
Other services and unrequited transfers	478	530	468	265	108	105
Current balance	-257	-835	-874	-1,432	-990	-430
Net capital inflows:	308	558	1,245	1,559	1,111	...
Nonbank private sector ^{2/}	-131	34	-159	62	-520	...
Financial sector	118	130	481	78	218	...
Public sector	322	395	921	1,419	1,413	...
Overall balance ^{3/}	51	-277	371	127	121	...
(In millions of SDRs)						
Trade balance	-1,083	-2,122	-2,172	-2,357	-1,416	-842
Current balance	-379	-1,298	-1,410	-1,989	-1,276	-539
Overall balance	75	-431	599	176	156	...
(Percentage change)						
Memorandum items:						
Volume of exports	10.3	8.4	8.1	0.8	6.0	7.7
Volume of imports	14.5	14.4	-4.5	2.1	-4.5	-0.5
Unit value of exports	6.5	8.8	8.8	16.1	12.0	7.0
Unit value of imports	4.9	13.5	17.9	18.8	8.5	5.0
Terms of trade (1975 = 100)	1.5	-4.1	-7.7	-2.3	3.5	1.9
Current deficit (in per cent of GNP)	-4.1	-11.5	-10.3	-14.2	-8.4	-3.3
Foreign reserves (in SDR millions)	2,064	1,693	2,255	2,291	2,389	1,760 ^{4/}
Reserve coverage (months of imports)	4.4	2.7	3.2	3.0	3.3	2.4
Effective exchange rate (1970 = 100)						
MERM	2.6	2.6	-0.3	-10.8	-3.1	...
Official index	0.5	-0.6	-4.0	-8.5	-0.6	...
Relative unit labor costs ^{5/}						
Relative to 14 industrial countries	2.3	3.6	--	-7.8	0.6	-3.0
Relative to EMS participants	2.3	6.0	8.6	0.1	2.7	-3.0

Sources: IMF, Balance of Payments Yearbook and International Financial Statistics; Central Bank of Ireland, Quarterly Bulletin; and data provided by the Irish authorities.

^{1/} Official forecasts.

^{2/} Including allocation of SDRs, other capital transactions, and errors and omissions.

^{3/} Including valuation adjustments.

^{4/} As at end-May, with gold valued at SDR 35 per ounce.

^{5/} Adjusted for exchange rate changes (staff estimates).

Table 3. Ireland: Summary of Current and Capital Budgets

(In millions of Irish pounds)

	1978	1979	1980	1981	1982		1983
					March budget estimate	Cash outturn	Budget estimate
Current revenue	2,023	2,384	3,155	3,973	5,270	4,908	5,758
Current expenditure	<u>2,420</u>	<u>2,906</u>	<u>3,702</u>	<u>4,775</u>	<u>5,949</u>	<u>5,896</u>	<u>6,655</u>
Current deficit	397	522	547	802	679	988	897
Capital expenditure, net	<u>413</u>	<u>487</u>	<u>670</u>	<u>920</u>	<u>1,004</u>	<u>957</u>	<u>825</u>
Exchequer borrowing requirement (EBR)	810	1,009	1,217	1,722	1,683	1,945	1,722
Memorandum items:							
Current budget deficit as per cent of GNP	6.3	7.2	6.4	8.0	5.6	8.2	6.9
EBR as per cent of GNP	12.8	13.8	14.3	17.1	13.7	16.6	13.2
Direct external borrowing by the Government, net	353	459	583	1,255	...	1,130	...
Domestic bank financing	232	228	240	175	...	235	...

Sources: Department of Finance, Budgets; and data provided by the Irish authorities.

Table 4. Ireland: Illustrative Medium-Term External Public Debt Scenario

(In per cent)

	1982 Actual	1983	1984	1985 Projected	1986	1987
Current account balance, in per cent of GNP	-8 1/2	-3 1/4	-1 1/2	-1	-1/2	--
External public debt in per cent of GNP:						
Gross	59 1/2	61 3/4	60	58 1/4	56	53 1/2
Net <u>1/</u>	43 1/2	46 3/4	45	42 3/4	40 1/4	37 1/4
Debt service payments, net, in per cent of exports of goods and services <u>2/</u>	16 1/2	14 3/4	13 1/4	11 1/4	11	12 3/4
Debt service payments, gross, in per cent of exports of goods and services	19	16 1/2	15	13	12 3/4	14 1/2
Of which:						
Interest payments	10	9 1/2	7 3/4	6 3/4	6	5

Source: Staff estimates. The main assumptions behind this scenario are as follows: Estimates for 1983 reflect the forecasts outlined in section II above. For the period 1984-1987 exports of goods and services are assumed to rise in real terms by 6 per cent per annum on the basis of growth in export markets averaging about 4 per cent per year and the fuller utilization of existing export capacity. The implied gains in market shares are, however, lower than those experienced in recent years. GNP growth is assumed to recover gradually over the period to an average of about 3 per cent per year leading to a corresponding recovery in import growth to an average of 5 3/4 per cent per annum. The annual increase in the GNP deflator is assumed to be 6 per cent and the terms of trade are assumed to remain stable. Import prices are assumed to be moving in line with world inflation (6 per cent per annum). External public sector borrowing covers the balance of payments deficit on current and private sector capital accounts and allows for a desired accumulation of reserves, with official reserves maintained at the equivalent of 3 1/4 months of merchandise imports. All new borrowings are assumed to be on floating interest rate (with an assumed 3 per cent real interest rate) and to be repayable in eight years, including a four-year grace period.

1/ External debt of the Government and the state-sponsored bodies, net of official reserves.

2/ Net of interest income on official reserves. About 95 per cent of official reserves are assumed to be invested abroad in short-term assets, bearing yields 1 percentage point lower than the interest rate on new borrowing.

Table 5. Ireland: Monetary Survey

(End of period data)

	1983	1980	1981	1982	1982			1983
	Feb.		Feb.	May	Aug.	Nov.	Feb.	
In millions of Irish pounds								
Net foreign assets	445	15.1	10.2	20.1	-21.0	64.2	40.7	14.9
Domestic credit, net	8,816	18.6	18.0	12.9	16.6	11.7	9.5	13.4
To government, net	2,038	29.1	11.0	20.0	21.3	-3.7	-1.5	25.2
To nongovernment	6,778	16.1	19.9	11.2	15.3	16.3	12.9	10.2
Other items, net	-1,451	22.6	18.0	16.1	8.0	13.8	20.4	-4.3
Broad money (M3)	7,810	17.7	17.4	12.9	15.1	13.2	10.1	16.5
Narrow money (M1)	1,644	10.3	8.2	7.1	7.8	2.6	4.2	8.8
Memorandum items:								
Velocity of circulation (M3) 1/	--	1.60	1.56	1.60	--	--	--	--
Private sector credit								
Central Bank guideline	--	18.0	13.0	15.0	--	--	--	--
Actual outcome	6,619	19.3	13.4	15.3	--	--	--	--
Broad money (M3)	7,810	15.7	25.0	15.1	15.1	13.2	10.1	16.5

(Credit policy years ending February)

Source: Central Bank of Ireland, Quarterly Bulletin.

1/ Ratio of GNP to average broad money stock.

Fund Relations with Ireland 1/

Date of membership	August 8, 1957
Quota	SDR 232.5 million
Proposed quota under Eighth General Review of Quotas	SDR 343.4 million
Fund holdings of Irish pounds	SDR 157.3 million, or 67.7 per cent of quota
Reserve tranche position	SDR 75.2 million
SDR holdings	SDR 92.1 million (105.5 per cent of net cumulative allocation)
Gold distribution (four distributions)	103,554.980 ounces
Exchange system	Since March 13, 1979 Ireland has participated, together with Belgium, Denmark, the Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands, in the exchange rate mechanism of the European Monetary System. Under this system, Ireland maintains spot exchange rates of the currencies of the other participants within margins of 2.25 per cent (in the case of the Italian lira, 6 per cent) above and below cross rates derived from central rates expressed in ECUs. The central rate of the Irish pound is currently ECU 1 = £Ir 0.717050. The one-to-one parity relationship with the pound sterling was discontinued on March 30, 1979.
Last consultation	The staff report for the 1981 Article IV consultation (SM/81/218, 11/10/81) was considered by the Executive Board on December 2, 1981 (EBM/81/149).

1/ As of May 31, 1983.