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August 14, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Ireland - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Ireland, which has been tentatively scheduled for discussion on Wednesday, September 11, 1985.

Mr. Vittas (ext. 8790) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

IRELAND

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Consultation with Ireland

Approved by L. A. Whittome and J. Boorman

August 13, 1985

I. Introduction

The 1985 Article IV consultation discussions with Ireland were held in Dublin from June 17 to June 24, 1985. The Irish representatives included officials of the Department of Finance, the Department of Industry, Commerce, Trade, and Tourism, and the Central Bank of Ireland. Meetings were also held with the Minister of Finance, Mr. A. Dukes, and the Governor of the Central Bank of Ireland, Mr. T. O'Cofaigh. The staff team comprised Messrs. Vittas, Dell'Anno, Hadjimichael, Thumann, and Young (EP), and Miss Moran as secretary (all EUR). Mr. Joyce and Mr. Leonard, Executive and Alternate Executive Directors for Ireland, respectively, participated in the discussions. Ireland has accepted the obligations of Article VIII, Sections 2, 3, and 4.

II. Background

1. Recent developments

Since the beginning of the 1980s, Ireland has experienced an export boom, which has reflected primarily a rapid expansion of export capacity in some industrial sectors. 1/ However, this boom has failed to generate a strong, broadly based, recovery in domestic economic activity for several reasons. First, interindustry linkages between the high growth sectors (which are dominated by foreign-owned firms) and the rest of the economy have remained weak. As a result, the export multiplier has been low. Second, the persistence of high budget deficits over a long period of time has led to the accumulation of a very large stock of public debt, nearly half of which is held abroad. Given also the increase in international interest rates in recent years, interest payments on the foreign component of the debt have risen sharply, absorbing a growing share of available resources and offsetting much of the stimulus from the expansion in exports. Moreover, the growth in debt service charges has forced the authorities to curb other spending or raise taxes, in order to bring the

1/ Between 1981 and 1984 the volume of merchandise exports increased at an average annual rate of 12 1/2 percent.

fiscal position under better control. 1/ Inevitably these measures of fiscal retrenchment have had a restraining influence on economic activity which tended to be exacerbated by the adverse effects of the high level of taxation on incentives to work and to invest.

With the spreading of the recovery in trading partner countries, the growth in exports gathered further momentum in 1984 (Chart 1). 2/ At the same time, the pace of fiscal retrenchment slowed. In response, the growth in real GDP accelerated from about 1/2 percent in 1983 to 3 3/4 percent (Chart 2). Real GNP, however, rose by only 2 1/4 percent as net factor payments abroad, including profit repatriation and royalty payments by Irish subsidiaries of multinational firms, increased sharply for the fourth year in a row to the equivalent of 10 percent of GDP. It is noteworthy that, whereas the cumulative increase in real GDP between 1980 and 1984 was about 9 percent, the growth in real GNP over the same period was a mere 2 percent.

After falling by more than 5 percent over the two years to 1983, real domestic demand was flat in 1984; private consumer spending and investment in plant and machinery showed modest increases, but these were offset by declines in all other components of investment and in public consumption. On the output side, the most notable feature in 1984 was the continued strong growth in manufacturing production (Chart 3). However, as in previous years, this growth was heavily concentrated in a few high-technology export-oriented sectors such as chemicals and electronics. In the traditional, more labor intensive industries the upturn in activity was inadequate to arrest labor shedding, while in the building and construction sector output fell for the fourth consecutive year. Despite the sizable overall growth in real GDP, total employment continued to decline. With the labor force growing rapidly, the unemployment rate rose to about 17 percent by mid-1985 compared with 16 percent at the end of 1983 and 8 1/4 percent at the beginning of the 1980s.

The rate of inflation, at the retail level, decelerated markedly from 10 1/2 percent in 1983 (and a peak of 20 1/2 percent in 1981) to 5 1/4 percent in the year to May 1985, partly on account of a much reduced impact (relative to previous years) of indirect tax increases (Chart 4). The growth in wage earnings slowed in the public sector but remained high in the private sector, especially in manufacturing. Nevertheless, because of an exceptionally large increase (15 1/2 percent) in productivity, unit wage costs in manufacturing actually fell by 4 1/4 percent and declined by 8 3/4 percent relative to the average in trading partner countries (after allowing for changes in exchange rates).

1/ Between 1981 and 1984 the noninterest component of total public expenditure fell from some 55 percent of GNP to about 50 percent of GNP, while tax revenue as a ratio to GNP rose from about 31 1/2 percent to almost 37 percent.

2/ All the charts referred to in the text appear at the end of this report.

The dispersion of pay increases tended to widen, though probably not sufficiently to reflect fully interindustry (and intercompany) differences in productivity and profit performance. Thus, significant differences in the competitive position of individual industries are likely to have persisted.

Despite a decline in the external terms of trade of nearly 2 percent and the continued large increase in net factor payments abroad, the balance of payments deficit on current account fell in 1984 to £Ir 0.8 billion or 5 3/4 percent of GNP (Chart 5). The deficit had been 15 percent of GNP only three years earlier. The decline in the deficit in 1984 was brought about largely as a result of an 18 percent increase in the volume of exports, which reflected the enhanced capacity of the electronics and chemical sectors, the strengthening of foreign demand for the output of other industries, a recovery in agricultural output, and some liquidation of agricultural intervention stocks previously accumulated under EC (CAP) arrangements. The volume of imports rose by about 9 percent, with the rate of increase in imports of materials for further processing being much higher than that for other imports.

The current account deficit in 1984 was financed to a large extent by new direct borrowing abroad by the Exchequer. However, such borrowing at about 4 1/2 percent of GNP was much lower than in previous years and accounted for a declining proportion of the total Exchequer Borrowing Requirement. Foreign borrowing by other state bodies and by banks also fell significantly in 1984, while nonbank private capital movements (including errors and omissions) resulted in a sizable outflow, part of which may have reflected unrecorded imports from Northern Ireland. In SDR terms, gross official reserves declined slightly during 1984 but increased sharply during the first six months of 1985 to SDR 3,477 million (over four months of merchandise imports). The external debt of the public sector rose from 68 percent of GNP at the end of 1983 to about 70 percent of GNP at the end of 1984. Despite the extremely high level of this debt, Ireland has continued to have little difficulty in raising capital abroad. Indeed, both in 1984 and so far in 1985, it has been able not only to cover its current requirements but also to refinance on favorable terms a sizable portion of outstanding debt falling due within the next few years. 1/ Together with the high level of unemployment, the easy access to foreign capital markets probably makes it difficult for the authorities to muster support for persevering with the adjustment effort.

Between 1981 and 1983, the Exchequer Borrowing Requirement (EBR) was lowered by more than 3 percent of GNP, notwithstanding the sluggishness of the economy over that period (Chart 6). In 1984 the EBR was reduced further by about 1 percent of GNP to 12 1/2 percent of GNP. This reduction was somewhat higher than expected in the budget, despite a shortfall

1/ The proportion of the Exchequer's external debt with maturities of over five years increased from 46 percent at the end of 1983 to 54 percent at the end of 1984.

in revenue, reflecting the authorities' success (for the first time in many years) in holding expenditure below the budget target. Nevertheless, it implied a considerable deceleration in the pace of correction of the fiscal disequilibria, given that activity (and domestic demand) were distinctly more buoyant than in the preceding years. The adjustment in the fiscal position has so far been brought about mainly through increases in the overall tax burden and a reduced level of capital spending. On the current expenditure side, the authorities have been reasonably successful in containing the growth in the wage bill, both through pay restraint and through a reduction in employment, but this has been overshadowed by the rise in the interest burden on the public debt (which now absorbs more than a third of total tax revenue) and the growth in transfer payments.

Because of sluggish sales of government securities to the domestic nonbank sector, much of the EBR in 1984 was financed by monetary means contributing to a high rate of domestic credit expansion (DCE) 1/ and some downward pressure on the external reserves. Toward the end of 1984, interest rates were raised markedly (Chart 7), leading in early 1985 to a revival of debt sales to domestic nonbanks and a strengthening of the capital account of the balance of payments. The growth in the money supply (broadly defined) in 1984, at 10 percent, was roughly in line with the growth in nominal GDP. Since late 1983, the Irish pound has generally maintained its position in the upper half of the EMS, and its effective (trade-weighted) exchange rate has fluctuated narrowly as the fairly large variations in the bilateral rate relative to the pound sterling and the U.S. dollar have tended to offset each other (Chart 8).

2. Short-term prospects

The official forecasts envisaged some slowdown in the pace of expansion of economic activity, a further decline in the rate of inflation and in the external deficit and--despite some small increase in employment--a further rise in the rate of unemployment. These projections differ only in minor detail from those emerging from the staff's forecast in the context of the latest WEO exercise.

The growth in real GDP is forecast to slow down to 2 3/4 percent in 1985, with the foreign balance remaining the principal expansionary force. However, its contribution is expected to be somewhat lower than in 1984, as the rate of growth of exports is forecast to decline in response to weaker growth in export markets. For the first time since 1981, final domestic demand is expected to make a positive contribution to GDP growth, equivalent to about 1 1/4 percentage points. Private consumer spending, which recovered somewhat in 1984 after a cumulative decline of more than 8 percent in the preceding two years, is expected to grow by more than 1 3/4 percent. The increase in 1985 is predicated on a rise of similar magnitude in real disposable income, due in part to tax

1/ DCE is defined, by convention, to include not only the change in net domestic credit but also the net foreign financing of the Exchequer.

reductions announced in the 1985 budget; the personal savings ratio is expected to remain practically unchanged. Public consumption is expected to rise by about 2 1/2 percent, largely on account of the introduction of a new special employment scheme. The recent recovery of investment in machinery and equipment is projected to continue, but investment in building and construction is expected to fall further, owing to the adverse effects of high real interest rates on the housing market and a large excess supply of office space. The change in stockbuilding is projected to make a negative contribution to GDP growth as a small increase in nonagricultural stocks is expected to be more than offset by a further rundown in agricultural intervention stocks. The continued expansion in net factor payments abroad would limit the growth in real GNP to 1 3/4 percent.

The current account of the balance of payments is projected to record a deficit of about £Ir 0.7 billion (4 1/4 percent of GNP) in 1985, somewhat below the deficit experienced in 1984. The trade balance is expected to swing into surplus, for the first time since the late 1960s, on account of growth in the volume of exports of 11 1/2 percent, an increase in the volume of imports of 7 percent, and little change in the terms of trade. Despite the favorable development in earnings from tourism, the invisibles balance (including unrequited transfers) is projected to deteriorate further in 1985.

The rate of consumer price inflation is projected to fall to 5 1/2 percent, mainly as a result of the continued moderation in wage demands and the strong growth in productivity. In manufacturing, for example, average weekly earnings are projected to increase by 7 percent, and with average productivity likely to rise again by more than 10 percent, unit wage costs would probably fall further and profits, especially in the export sector, should rise markedly. Employment is not expected to rise sufficiently to absorb the growth in the labor force, and the unemployment rate is expected to increase from an average of 16 1/4 percent in 1984 to over 17 percent in 1985.

Real GDP is expected to continue to rise in 1986 at about the same pace as in 1985, but it is likely that the growth in net factor payments abroad will slow down markedly on account of the recent easing of international interest rates. This would allow a narrowing of the gap between real GDP growth and real GNP growth and should also contribute to a further small reduction in the external current account deficit (in relation to GNP). On the assumption that the recent trend toward increased wage restraint will continue, the staff would foresee some further fall in the rate of consumer price inflation in 1986, even though productivity gains are likely to be noticeably smaller than in the recent past.

III. Policy Issues

During the 1984 Article IV consultation with Ireland, Directors commended the authorities for the progress that they had made in lowering inflation and the balance of payments deficit on current account (SUR/84/143, 9/14/84). At the same time, Directors expressed concern that the current budget deficit and the EBR were unsustainably high and stressed that the main thrust of the adjustment policies must be a further correction of fiscal imbalances. Directors strongly emphasized that the corrective measures should focus on expenditure restraint, including restraint with respect to public sector pay and social welfare benefits. While expressing satisfaction with the reduction in net official foreign borrowing that had been achieved over the preceding two years, Directors strongly encouraged the authorities to reduce such borrowing further and to pursue a further improvement in the external current account.

In late September 1984, the authorities introduced a new medium-term economic and social plan covering the three-year period to 1987 (which is the final year of the Government's present term in office). While reaffirming their commitment to further macroeconomic adjustment, the authorities announced in the Plan their decision to abandon their earlier objective of eliminating the current budget deficit by 1987. Noting that interest rates were still high and that the economy was just pulling out of recession, the authorities judged that the deflationary effect of the measures that would be needed to achieve the original objective would be so great as to damage the economy's vitality for many years to come. Instead, a new, more modest, objective was set, calling for a reduction in the current budget deficit to the equivalent of 5 percent of GNP by 1987. In addition, quantitative targets were set for the first time for the EBR and the total public sector borrowing requirement (PSBR). In relation to GNP these are to be reduced by 1987 to 9 3/4 percent and 11 1/4 percent, respectively, from 12 1/2 percent and 16 1/2 percent in 1984. The authorities stressed that with the attainment of these objectives, the need for recourse to foreign borrowing would be greatly reduced, as would be pressure on the domestic financial markets--thus freeing up a larger share of domestic savings for productive investment outside the government sector.

In the 1985 consultation discussions, the mission sought to assess the Plan's fiscal objectives and the adequacy of the steps which the authorities have taken or are contemplating to promote their achievement. Considerable attention was also given to the unemployment situation and the scope for policies to improve the functioning of the labor market and the longer-term prospects for employment growth.

1. Fiscal policies

Some details of the program of fiscal adjustment envisaged in the National Plan are given in Table 1. As indicated in this table, the targeted decline in the current budget deficit in relation to GNP is to be brought about entirely through a reduction in the ratio of current expenditure to GNP, reversing the steep upward trend observed in the past.

Table 1. Ireland: Profile of Fiscal Adjustment

(In percent of GNP)

	1981	1984	1985	1987	Change Between 1984 and 1987
	Outturn		Budget	Target	
Current expenditure	45.2	48.4	49.1	46	-2 1/2
Central fund 1/	9.5	13.3	14.5	13 1/4	--
Supply services	35.6	35.0	34.6	32 3/4	-2 1/4
Pay component	16.3	16.2	15.8	14 1/2	-1 3/4
Nonpay component	19.3	18.8	18.8	18 1/4	-1/2
Current revenue	37.6	41.2	41.2	41	-1/4
Tax	31.4	36.7	36.7	36 1/2	-1/4
Nontax	6.2	4.5	4.5	4 1/2	--
Current budget deficit	7.6	7.2	7.9	5	-2 1/4
Capital budget deficit	8.7	5.4	5.0	4 3/4	-3/4
Exchequer borrowing requirement	16.3	12.6	13.0	9 3/4	-3
Borrowing by state-sponsored bodies and local authorities	4.6	4.0	3.2	1 1/2	-2 1/4
Public sector borrowing requirement	20.9	16.6	16.2	11 1/4	-5 1/4

Source: Department of Finance, Budgets and National Plan, 1984.

1/ This item consists largely of debt service charges.

The containment of spending, in turn, is to be achieved mainly through tight restraint on the Government's pay bill, which in 1984 accounted for about one third of total current outlays. To this end, precise cash limits on the pay bill have been set for each of the three years of the Plan; these limits imply that average pay rates will have to be reduced markedly in real terms, if severe reductions in public service staffing are to be avoided. Further measures to curtail spending include curbs on recruitment by local authorities and other state bodies, continuation of the policy initiated in 1982 of replacing only one out of three vacancies in the civil service, increases in charges for some health and education services, and elimination or rationalization of wasteful or unproductive services. However, the specifics of some of these measures have yet to be decided. The authorities have given a commitment to at least maintain the real value of long-term social welfare payments and to adjust short-term benefits (such as unemployment and disability benefits) in line with take-home pay.

The Plan envisaged that, as a ratio to GNP, the current budget deficit would initially increase somewhat in 1985 (to about 8 percent) and then fall steadily in 1986 and 1987. The increase in the deficit planned for 1985 was confirmed in the 1985 budget (Table 2). It reflected primarily a large increase in debt service charges, equivalent to about 1 percent of GNP, which the authorities did not consider desirable to offset with cuts in other spending, as they expected that it would be reversed in subsequent years in response to projected declines in interest rates.

The provision for the pay bill in the 1985 budget is higher than envisaged in the Plan as the Government has decided to accept a pay settlement for the public service which--while moderate by comparison with past trends and the current rate of inflation--is nevertheless higher than assumed in the Plan. The settlement followed a seven-month pay pause and provided for a 3 percent increase in pay rates in January 1985 and a further 3 percent increase in July. The Irish representatives noted that the settlement was reached after recourse to the arbitration process and the arbitrator had acknowledged for the first time that the Government's ability to pay was not unlimited. It was initially intended that the cost of the settlement would by and large be accommodated within the overall budgetary arithmetic underlying the Plan, in part as a result of increased buoyancy of tax revenue relative to earlier projections. In the early months of 1985, however, tax revenue had been considerably below expectations. Although the trend had since improved, the Irish representatives agreed that the outturn for the year remained somewhat uncertain. Moreover, a small overshooting of the pay bill seemed to be emerging. The Irish representatives recognized that the achievement of the budgetary targets in 1985 was of paramount importance in maintaining the pace of fiscal retrenchment contemplated in the Plan and recalled that the authorities had indicated willingness to take additional action, if necessary, to correct any significant deviation from these targets. However, official statements made after the return of the mission to headquarters suggest that a small overrun on the budget deficit (of up to about 1/2 percent of GNP) would probably be tolerated.

The Irish representatives recognized that the Plan's cash limits on the pay bill for 1986 and 1987 appeared rather severe, particularly in the light of the latest trends, and that because of demographic developments, pressures on social expenditure would continue. It was, therefore, likely that the Government would have to identify other areas of restraint, extending beyond public sector pay, if its medium-term targets for expenditure and the deficit were to be adhered to.

An important objective of the authorities, in the context of the National Plan, is to arrest the rise in the share of national output absorbed by taxation. In the three years to 1984 this share increased by more than 5 percentage points (to 36 3/4 percent), in part on account of fiscal drag and in part because of the authorities' heavy reliance on increased taxation as a means for improving the fiscal position. It has been recognized that the overall burden of taxation has reached a level which impinges adversely on incentives to work and probably encourages the growth of the underground economy. The Irish representatives noted that the state of the public finances makes it difficult to contemplate a reduction in the burden of taxation in the foreseeable future. However, in the National Plan the authorities have made a commitment to avoid any further increase in the overall tax burden and, with respect to personal taxation, to adjust annually income tax bands and allowances in such a way that the average income tax burden would not change. The authorities have also announced their intention to introduce in 1986 a new farm tax, based on land holdings, and to continue their efforts at broadening the tax base and simplifying the tax system, especially with a view to redistributing the tax burden away from the PAYE sector.

The 1985 budget contained tax changes to meet these commitments. Personal income tax allowances were raised and the number of rate bands was reduced from five to three. Moreover, the standard 35 percent rate band was widened considerably and the top rate was lowered from 65 percent to 60 percent. As for indirect taxation, the maximum rate of VAT was lowered from 35 percent to 23 percent, the number of VAT rates was reduced from six to three, and the VAT base was extended to cover adult footwear. The Irish representatives noted that these measures implied a significant rationalization and simplification of the tax system and should help reduce incentives for the diversion of spending to Northern Ireland (where the VAT rate is 15 percent). They recognized, however, that several weaknesses in the tax system, stemming in large part from the array of tax reliefs and allowances to the personal sector and tax-based incentives to the company sector had not yet been adequately addressed.

Exchequer borrowing for capital purposes (as a ratio to GNP) has declined markedly over the last three years, reflecting the tapering off of expenditure on certain major projects and to a lesser extent a fall in capital grants to the private sector. The Irish representatives said that the winding down of the investment programs in the energy and communications sectors will allow a further small cut in the relative size of Exchequer borrowing for capital purposes during the period of the National Plan, even though expenditure on road construction and educational facilities is planned to rise markedly in real terms.

A significant contribution to the planned improvement in the public finances was projected to come about through a reduction in the financing needs of the local authorities and state-sponsored bodies (Table 1). The financial position of some of these bodies has been weak due to a variety of reasons including (a) failures in project design and execution which have frequently resulted in large cost overruns; (b) excessive emphasis on the pursuit of social policy objectives which have caused overmanning and distorted pricing structures; and (c) overly high gearing ratios. The authorities have, however, begun to address these problems. Comprehensive guidelines for a rigorous appraisal of projects were issued in 1983 and since 1984 all commercial state-sponsored bodies have been required to prepare (and update annually on a rolling basis) five-year corporate plans which are used also for monitoring closely their performance. In addition, the capital structure of some bodies has been strengthened through the injection of Exchequer funds. Overall, the net operating losses of commercial state-sponsored bodies has fallen from 7 percent of turnover in 1981 to 1 percent in 1984, and the losses have been confined to a few enterprises in industry and the transportation sector. The Irish representatives said that a further improvement was expected over the next few years. To this end, the authorities intend to continue to refine the indicators used to monitor and assess the financial performance of state enterprises, and from 1986 they will begin to set annual nonnegotiable limits on borrowing by these enterprises.

The large fiscal imbalances have led to a rapid increase in the national debt to 128 percent of GNP in 1984, compared with 97 percent in 1981 and 72 percent in 1975. The Irish representatives confirmed that the achievement of the fiscal objectives of the National Plan would allow the ratio of the national debt to GNP to stabilize by 1987, albeit at a level higher than at present.

2. Monetary policy and budget financing

Membership of the European Monetary System (EMS) and the large financing needs of the Exchequer constrain the ability of the authorities to influence the monetary aggregates and the rate of inflation. Accordingly, monetary policy has continued to be directed primarily toward the protection of the external value of the Irish pound, through the maintenance of an adequate level of official external reserves. In 1982 and 1983, the reduction in the relative size of the EBR, coupled with the progress achieved in mobilizing domestic resources for the financing of the EBR, allowed a significant slowdown in domestic credit expansion (DCE) from over 40 percent in 1981 to 24 3/4 percent in 1983. 1/ In 1984, however, the authorities encountered difficulties in their domestic funding program, associated in part with uncertainties regarding the course of domestic interest rates and in part with some changes in tax provisions that tended to discourage, at least initially, purchases of government securities by the nonbank public. As a result, the share of nonmonetary financing of the EBR fell sharply to 29 1/2 percent from almost 42 percent in 1983 and, despite a significant deceleration in the rate of growth of bank lending to the private sector, DCE rose to 26 1/4 percent (Table 3). The rate of growth in M3 accelerated from 5 1/2 percent during 1983 to 10 percent during 1984, broadly in line with the Central Bank's expectations at the beginning of the year.

1/ DCE over a specified period is expressed as a ratio to the broad money supply outstanding at the beginning of the period.

Domestic interest rates were relatively stable for most of 1984 but strong upward pressure emerged during the last quarter of 1984, reflecting mainly the impact on domestic financial markets of the large financing requirement of the Exchequer. The authorities initially resisted this pressure by stepping up their support to the money market, but reversed their position and allowed interest rates to rise sharply when it became clear that this policy was having an adverse effect on the external position. The increase in domestic interest rates took place against a background of easing interest rates in world financial markets and, combined with the sharp deceleration of inflation in Ireland, gave rise to a favorable real interest rate differential during late 1984 and early 1985 (Chart 9). There was, in response, a marked recovery of the demand for government gilts by both the domestic nonbank sector and by nonresidents and a strengthening of the capital account of the balance of payments. The latter contributed to an easing of domestic liquidity conditions and the gradual reversal over the recent past of the increase in interest rates that had taken place in late 1984. The authorities adopted a cautious approach with respect to interest rate policy, allowing rates to fall only when the level of official support to the money market had fallen close to zero.

During the first four and a half months of 1985 the annual rate of growth in M3 remained stable at just over 10 percent, while domestic credit expansion decelerated markedly. The Irish representatives considered these developments to be consistent with the monetary policy objectives set for 1985, which included the alleviation of financial strains resulting from the imbalances in public finances and the pursuit of an interest rate policy that would facilitate the flow of savings from the nonbank public to the Exchequer. For 1985 as a whole, DCE is expected to decelerate to about 22-24 percent.

In 1984 the authorities had announced a precise target for Exchequer recourse to foreign borrowing. This target was met in the early part of the year and the market's knowledge that the balance of the Exchequer's financing needs would have to be met in full domestically had contributed, in the view of the Irish representatives, to a disruption in the pattern of gilt sales in late 1984 and the associated upward pressure on interest rates. In light of this experience, the authorities did not adopt in 1985 any quantitative target for the foreign financing of the Exchequer. In the first six months of 1985 net foreign borrowing by the Exchequer exceeded £Ir 900 million, compared with £Ir 649 million for 1984 as a whole, while purchases of government securities by nonresidents jumped from very modest levels in past years to nearly £Ir 300 million. However, domestic sales of debt to nonbanks were also very buoyant and the Exchequer had accumulated large balances with the Central Bank. The Irish representatives did not rule out net repayments of foreign debt during the remainder of 1985 but added that it was not possible at this stage to anticipate the final split between foreign and domestic financing of the EBR.

3. External adjustment

The Irish representatives viewed the decline in the external current account deficit from over 15 percent in 1981 to less than 6 percent in 1984 as an overall measure of the success of their external adjustment policies. They recognized, however, that this improvement was not wholly related to gains in competitiveness but reflected also changes in the relative cyclical position of the Irish economy. They stated that a further strengthening in competitiveness and the external position was required as a key condition for the creation of a sufficient number of jobs for the growing labor force. Consequently, the objectives with regard to external adjustment laid down in the National Plan included a further reduction in the external current account deficit to about 3 percent of GNP by 1987 and a reduction, or at least a stabilization, of the Exchequer foreign debt and foreign debt servicing in relation to GNP.

Changes in the index of relative unit wage costs suggest a large cumulative improvement in the competitive position of the Irish manufacturing sector in recent years (Chart 10). Some caution in interpreting this index is, however, warranted as much of the improvement reflects exceptionally large increases in average productivity associated not only with the shift in the composition of output toward capital-intensive high-tech industries but also the high rate of labor shedding in the traditional industries. Earnings, in national currency terms, have continued to rise faster in Ireland than abroad, although after adjusting for exchange rate changes the relative position has changed only marginally in the recent past. The Irish representatives were optimistic that the growth in earnings would continue to decelerate in the current pay round, given the very high level of unemployment and the slowdown in inflation. For 1985, they expected the increase in earnings in the manufacturing sector to be of the order of 7 percent, of which 5 percentage points would reflect a carry-over from the 24th pay round.

Over the medium term, the authorities intend to bring down pay rises to those prevailing on average in competitor countries. Since average productivity was likely to grow somewhat faster in Ireland than in her main trading partners, as the process of modernization and structural change continued, cost competitiveness would improve. The authorities also aim at upgrading other aspects of competitiveness such as adaptation to technological change, product quality, marketing skills, and reliability of delivery, as sectoral studies have demonstrated the existence of significant weaknesses with regard to these factors in the traditional Irish industries.

The Irish representatives reiterated their belief that a depreciation of the Irish pound would not contribute to a sustainable improvement in competitiveness as the available evidence indicated that domestic costs and prices tended to respond fully and relatively rapidly to changes in the exchange rate. Accordingly, the general aim of exchange rate policy, which was operated on the basis of membership in the EMS, taking into account domestic economic circumstances, was to keep the external value of the Irish pound as stable as possible, so as to help reduce inflation. Obviously, exchange rate policy also had to take into account movements in other exchange rates. In particular, because of its relative importance for the Irish economy, a significant movement in sterling could not be ignored. In considering a response to such a movement the authorities would be concerned to avoid precipitate action, having regard to the volatile behavior of the pound sterling in the past.

The staff's illustrative medium-term external debt scenario indicates that the reduction of the external current account deficit to about 3 percent of GNP by 1987 would require a continuation of gains in export market shares, though at a slower pace than in the recent past, a decline in international interest rates in line with assumptions embodied in recent WEO exercises, and the maintenance of a broadly restrictive posture with respect to the evolution of domestic demand. Even under these assumptions, however, the external public debt in relation to GNP would rise somewhat in 1985 and 1986, and would then fall only slightly (Table 4), while interest payments would continue to absorb a sizable portion of national resources throughout the simulation period. An alternative scenario that assumes no gains in market shares and higher interest rates suggests a sharp increase in the current account deficit and in external public debt to 7 percent and 82 percent, respectively, by the end of the decade. It seems, therefore, that the attainment of the Plan's external objectives is the essential minimum for ensuring the viability of the external position over the medium term.

The maintenance of an adequate level of external reserves for the defense of the exchange rate is viewed as a primary responsibility of the monetary authorities. In assessing reserve adequacy, the authorities take into account the fact that the external current deficit has been financed mainly by foreign borrowing, entailing a rapid buildup in the external indebtedness of the public sector and consequent servicing costs.

4. Income and labor market policies

The authorities view the high level of unemployment as the most serious problem facing the Irish economy. Although the rise in unemployment has slowed down since early 1984, its average duration has tended to lengthen and currently about 40 percent of the unemployed have been out of work for more than a year. Moreover, the prospects for a significant reduction in the unemployment rate are bleak, not least because of the projected rapid expansion of the labor force 1/ and the apparent weakness of the link between output and employment growth.

The Irish representatives noted that, in order to ameliorate conditions in the labor market, the authorities have taken measures to improve the supply performance of the economy, while emphasizing the need for wage moderation and greater flexibility in wage relativities. Industrial

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1/ The National Plan assumes that in the three years to April 1987 the labor force will grow at an annual rate of a little over 1 percent.

policy was modified in 1984 mainly with a view to enhancing interindustry linkages between foreign-owned and indigenous firms. 1/ Since end-1981 wage and salary increases have been determined on a decentralized basis (in contrast to the system of national agreements which prevailed over the previous decade) and the Government has increasingly stressed to employers, unions, and third-party arbitrators the need to have regard to the ability to pay of individual firms and to the implications of pay settlements for the preservation and creation of jobs. This approach had met with some success, contributing to a deceleration in the average rate of pay increases while allowing greater variation in the timing and the size of individual pay awards.

Whereas some progress has been made in promoting wage flexibility, the authorities have been less successful in dismantling other labor market rigidities. Due to the high and rising level of taxation on individuals and the impact of increased payroll taxes, a sizable "wedge" has emerged between the real labor costs that the employer must bear and the real net wages received by the employee. 2/ Thus, despite the reduction in real wages in recent years (Chart 11), the demand for labor has remained weak and labor shedding has continued, albeit at a decelerating pace. Moreover, partly because of the fall in real disposable wage incomes, replacement ratios have remained high (notably for low to moderate income earners with children) even though a number of measures have been taken since 1983 to curb unemployment benefits. 3/ The Irish representatives noted that the problem of high replacement ratios, which tended to reduce incentives to seek work (and the related problem of high disability and sickness benefits which probably contributed to absenteeism) could be attributed in large part to the nontaxation of short-term social welfare benefits. They added that it was the stated intention of the Government to bring such benefits into the income tax network within the period of the Plan, if the necessary administrative arrangements for integrating the tax and benefit systems could be made in time.

The Irish representatives felt that minimum wage legislation was not in itself a significant source of inflexibility in the labor market as it applied only to a small proportion of the work force in a few industries. However, high starting pay rates for young people were a matter of concern. These rates were determined by arbitration and any changes would involve difficult political decisions. It was also believed, at least by some employer organizations, that the existing legislation on recruitment,

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1/ The main changes in industrial policy were discussed in SM/84/209 (8/31/84) and are reviewed in detail in the 1985 OECD survey of the Irish economy. The changes do not involve any significant change in the cost of industrial assistance which remains high. The authorities intend to keep industrial policy under review every three years.

2/ According to OECD estimates, from 1979 to 1984 real labor costs increased by about 10 percent while real after-tax labor earnings fell by 15 percent.

3/ For more details, see Appendix I of the recent economic developments paper.

dismissals, and conditions of employment--introduced for the most part in compliance with EC directives in social policy--was impacting adversely on the demand for labor.

In an attempt to assist specifically the young and the long-term unemployed, the authorities have added a number of new special employment schemes to the already existing ones, including the Social Employment Scheme and the Training and Placement Alternance Scheme (for details see the recent economic developments paper). It is envisaged that altogether these special employment schemes will provide 25,000 jobs by April 1987 and will allow the unemployment rate to fall slightly.

5. Trade and aid policies

The Irish representatives said that there had been no significant changes in trade policy since the last consultation. The authorities have expressed support for a new round of multilateral trade negotiations, while pointing to the need for some measure of protection for the domestic textile, clothing, and footwear industries which are highly labor intensive and face severe competition from developed and developing countries. In addition, because of Ireland's high dependence on agriculture, the authorities have been in favor of the Common Agricultural Policy of the EC, which involves reserving the EC market to a considerable extent for EC farmers and giving export rebates to facilitate the disposal of surplus production.

Official development assistance amounted to £Ir 33.8 million (0.23 percent of GNP) in 1984 and the allocation for 1985 is £Ir 38.4 million (0.25 percent of GNP). The National Plan provides for an increase in ODA to over £Ir 50 million by 1987, which is expected to be equivalent to 0.28 percent of GNP.

IV. Staff Appraisal

In mid-1981 the Irish authorities embarked upon a medium-term program of adjustment aimed at correcting the unsustainable internal and external imbalances that had been allowed to emerge in the wake of the oil shocks of the 1970s. While a significant measure of macroeconomic adjustment has since been achieved, the economic situation remains unsatisfactory and in some respects it has continued to deteriorate. To be sure, the rate of inflation has been brought down steeply and is now comparable to the average rate in Ireland's main trading partners. Moreover, after a period of stagnation, economic activity has recently picked up in response to good export performance. Nevertheless, employment has continued to fall and unemployment has risen further, reaching some 17 percent of the labor force in mid-1985. While the deficit on the current account of the balance of payments has been reduced markedly since 1981, it has nevertheless remained uncomfortably large, especially when viewed against the level of unemployment.

On the policy side, the EBR and the PSBR remain very high even though their ratios to GNP have been lowered by several percentage points since 1981. Total public debt and its foreign component have continued to rise, reaching levels which in relation to GNP are among the highest in the industrial world. The cost of servicing the public debt has therefore escalated, pre-empting a large and growing share of tax revenue and frustrating the effort to bring the current budget deficit under control. Moreover, as much of this effort has entailed a large increase in the tax burden on wage earners rather than a curtailment of public services or a reduction of tax expenditures, it has tended to undermine incentives to work and to save, thereby aggravating indirectly the unemployment problem.

The scale of the continuing disequilibria in the public sector makes it all the more important to proceed rapidly toward their correction. As Executive Directors stressed on the occasion of the 1984 Article IV consultation with Ireland, the longer adjustment is delayed, the more severe the corrective measures will eventually have to be; the implications for the reduction in living standards that will in the end have to be accepted are obvious. In view of this, the increase in the relative size of the current budget deficit and the EBR that has been budgeted for 1985 must be viewed with serious concern. This concern has been heightened by the results for the first half of the year which suggest that the outturn of the public finances for the year as a whole might fall short even of expectations in the budget. It is therefore essential that the authorities take early and resolute action to minimize any slippage in the implementation of the 1985 budget and to ensure the resumption of rapid fiscal adjustment in 1986.

The decision taken by the authorities, in the context of the National Plan, to scale down markedly their medium-term budgetary objectives is also cause for concern, as it implies the continuation for several years to come of a sizable amount of borrowing simply to finance current spending. The attainment of the revised objectives rests not only on success in maintaining tight pay restraint in the public sector but also on assumptions regarding the evolution of real interest rates which may turn out to have been unduly optimistic. Given the large size of the national debt already outstanding and the prospect of further additions to it, real interest rates in Ireland are unlikely to drop below the rate of growth of real GNP in the foreseeable future. The important objective of arresting, let alone reversing, the growth in debt service charges as a ratio to GNP is therefore unlikely to be achieved in the absence of determined and substantial discretionary measures designed to curb the Government's borrowing requirements.

In view of the authorities' welcome commitment not to raise further the overall tax burden, the needed fiscal retrenchment will require tight restraint on public spending. In this regard, the success that the authorities have had in promoting the view that pay settlements in the public sector have to be guided by the ability-to-pay principle is heartening. It will, nevertheless, need to be built upon in the future if the pay provisions of the Plan are to be adhered to. Equally important, however, the ability-to-pay principle has to be extended so as to apply to other components of government spending, e.g., social welfare benefits and rapid progress also needs to be made in trimming subsidies to state-sponsored bodies and state assistance to industry.

The steps taken in 1985 to simplify the personal income tax and VAT systems are encouraging. They nevertheless need to be reinforced by bolder initiatives to restructure the tax system so as to make it possible to lower the high burden of taxation borne by the PAYE sector. In this connection, measures, such as the taxation of unemployment and other short-term social welfare benefits deserve to be given priority as they would not only help to broaden the tax base but also strengthen incentives to work. It is also important to reverse the erosion of the personal income and company tax bases and to correct the distortion in relative factor prices that results from the proliferation of tax reliefs and other tax expenditures.

The return to free collective bargaining since end-1981 has contributed to a deceleration in the average rate of pay increases while allowing some variation in the size of individual awards. Nevertheless, average labor earnings have continued to rise more rapidly in Ireland than in her main trading partners, and the competitive position of some segments of Irish industry has remained under pressure. It is therefore clear that further progress needs to be made in restraining labor costs in Ireland, relative to those abroad. Reforms of the tax and social welfare systems can have a salutary effect on the functioning of the labor market and thereby contribute to pay moderation and a general lowering of the costs of employing labor. They should therefore be pursued with a sense of urgency. In addition, the role that exchange rate policy might be able to play in enhancing, or at least preserving, competitiveness and employment opportunities needs to be kept under review.

In the recent past, the authorities have taken advantage of favorable conditions in world financial markets in order to improve, through refinancing operations, the maturity profile of the external debt. This development is welcome. The authorities have also decided not to set specific quantitative targets for their foreign borrowing program in 1985. The increased flexibility implicit in this decision could help avoid unwarranted pressures on the domestic capital market. It does not, however, obviate the need for scaling down quickly and progressively foreign borrowing by the Exchequer and other public sector bodies so as to reduce the heavy drain on national resources represented by debt interest payments abroad and Ireland's vulnerability to sudden changes in sentiment in international capital markets. In view of the large net foreign borrowing already undertaken so far in 1985, a reduction in the outstanding amount of the external debt in the remainder of the year would be desirable, even if it could be achieved only at the cost of an increase in domestic interest rates relative to those abroad.

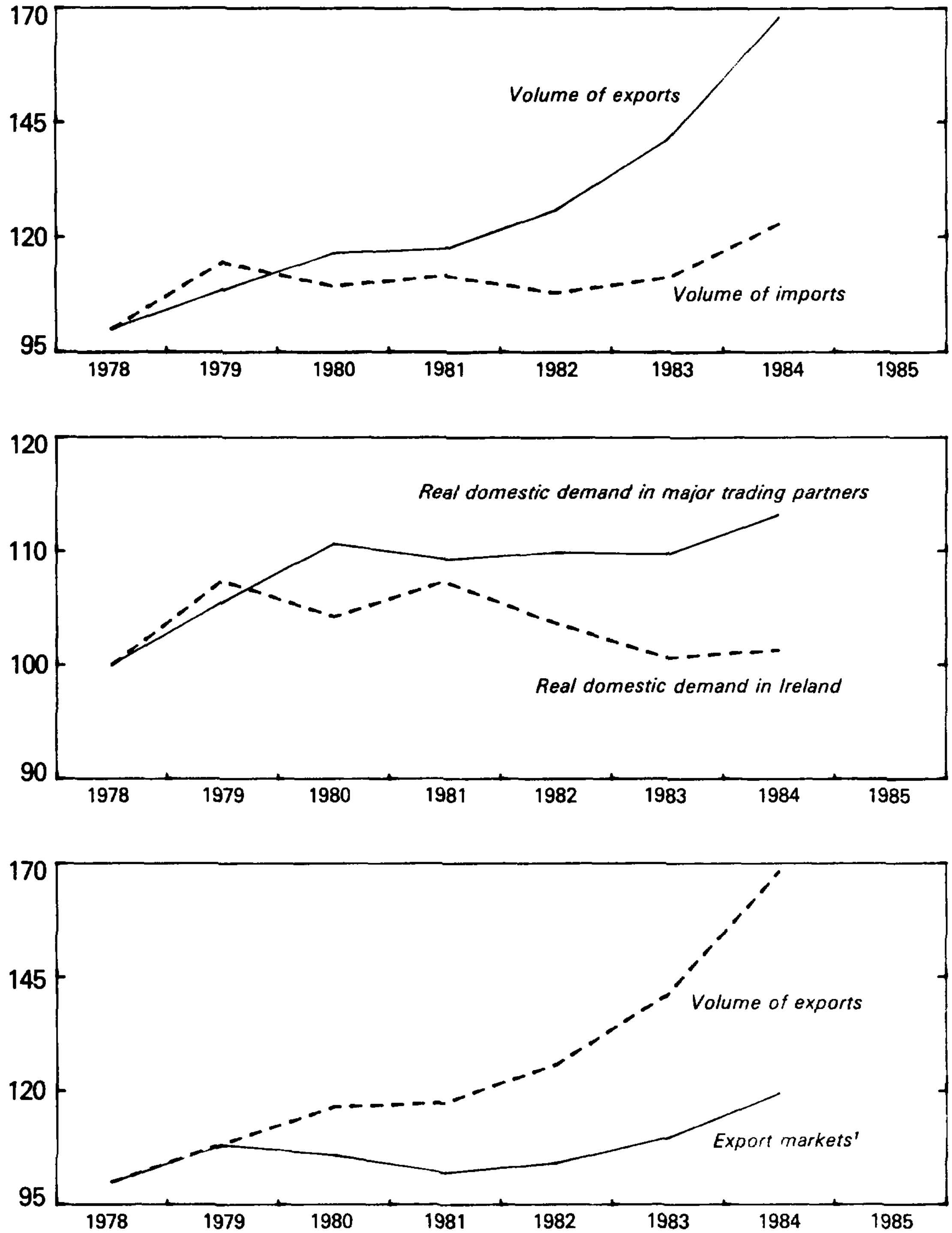
It is recommended that the next Article IV consultation with Ireland be held on the standard 12-month cycle.

CHART 1

IRELAND

DEVELOPMENTS IN THE VOLUME OF EXPORTS AND IMPORTS

(1978=100)



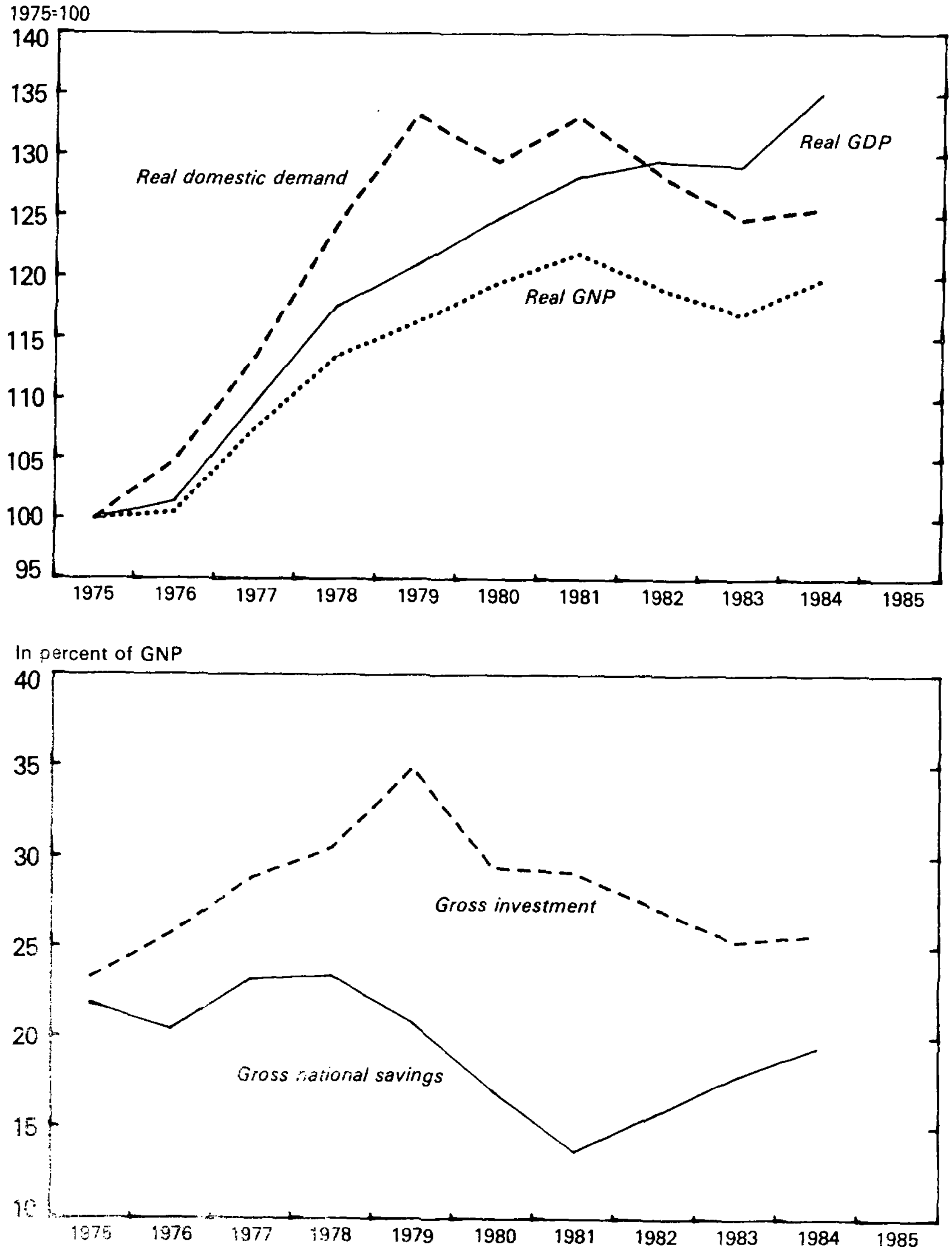
Sources: IMF, *International Financial Statistics;* and staff estimates.

[1]Weighted average (using bilateral export shares in 1980) of the volume of imports of the 14 major trading partners.

CHART 2

IRELAND

AGGREGATE OUTPUT AND EXPENDITURE



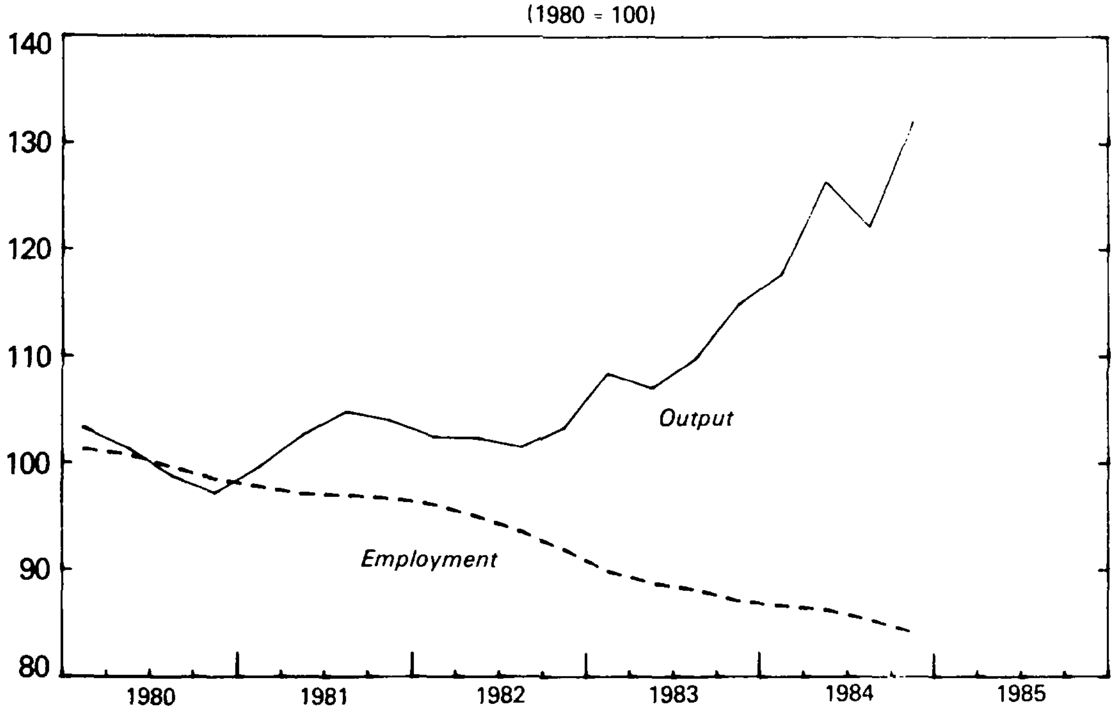
Sources: Central Statistical Office, *National Income and Expenditure*, 1982; Central Bank of Ireland, *Annual Report*, 1985, and data provided by the Irish authorities.

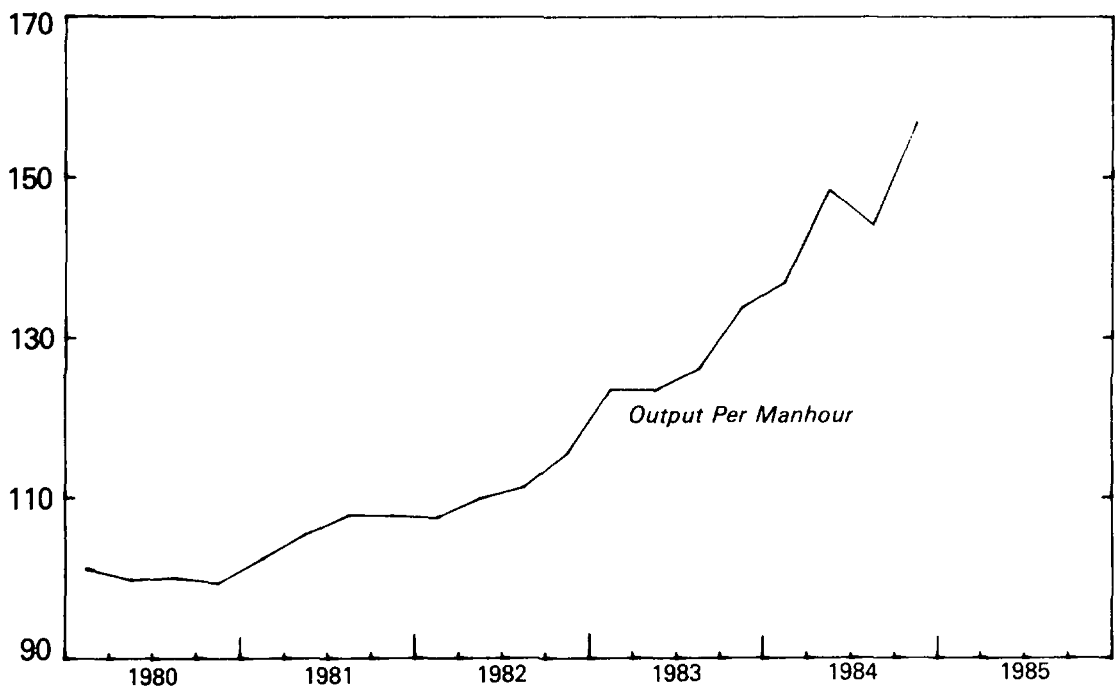
CHART 3

IRELAND

OUTPUT AND EMPLOYMENT IN MANUFACTURING

(1980 = 100)





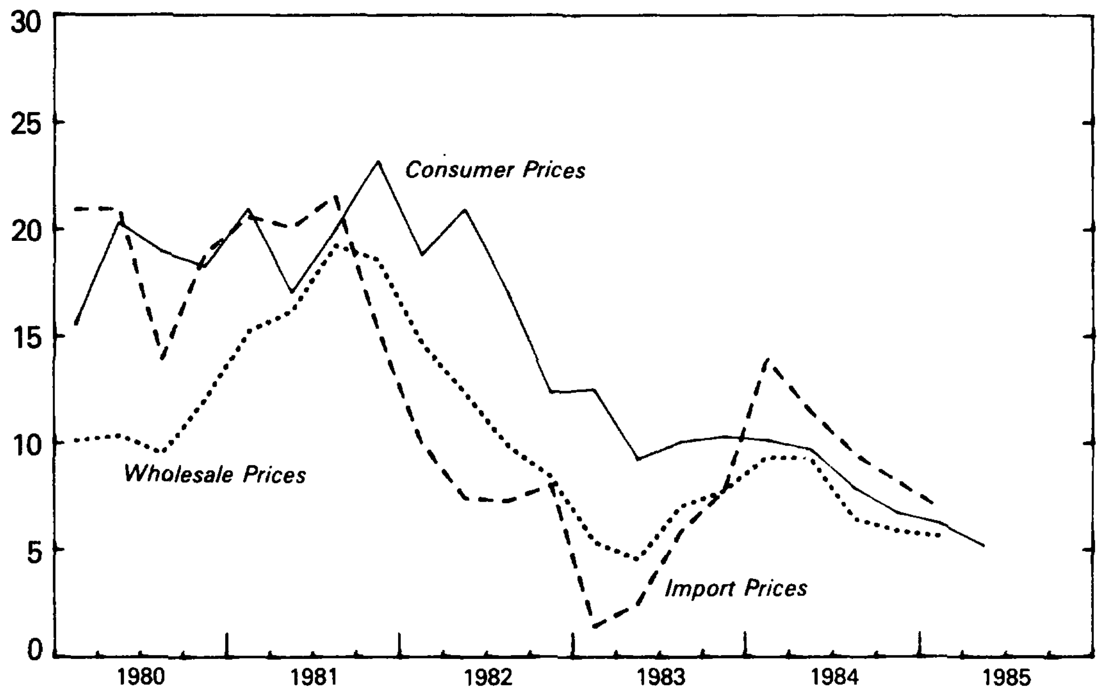
Source: Data provided by the Irish authorities.

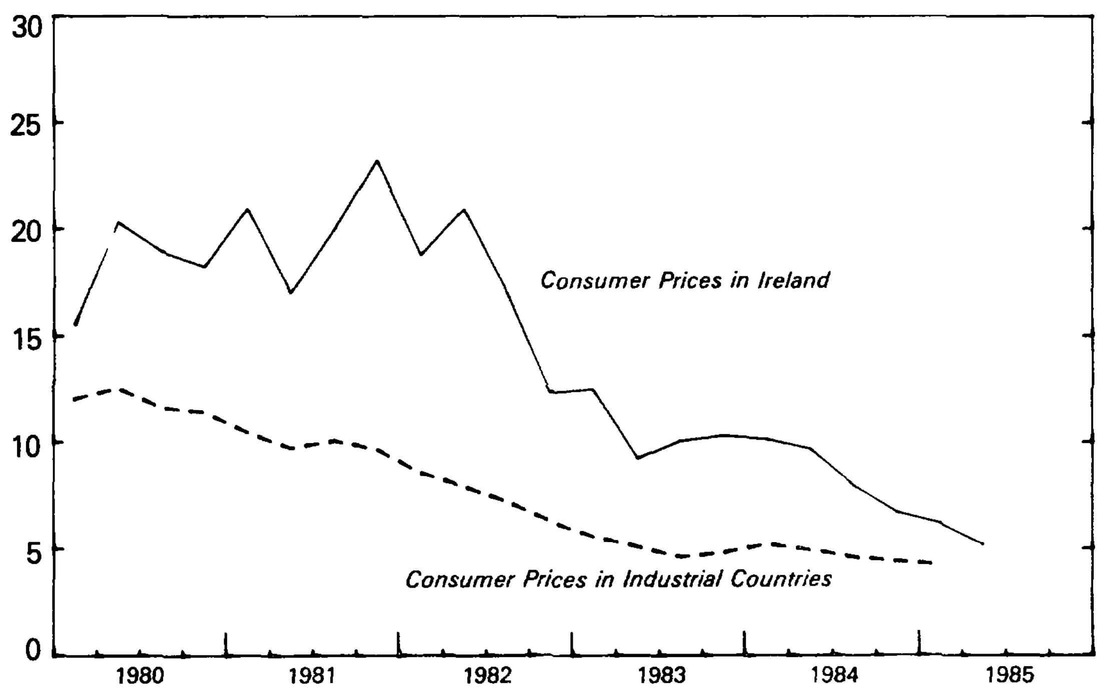
CHART 4

IRELAND

PRICE DEVELOPMENTS

(Percentage change from corresponding period in the previous year)





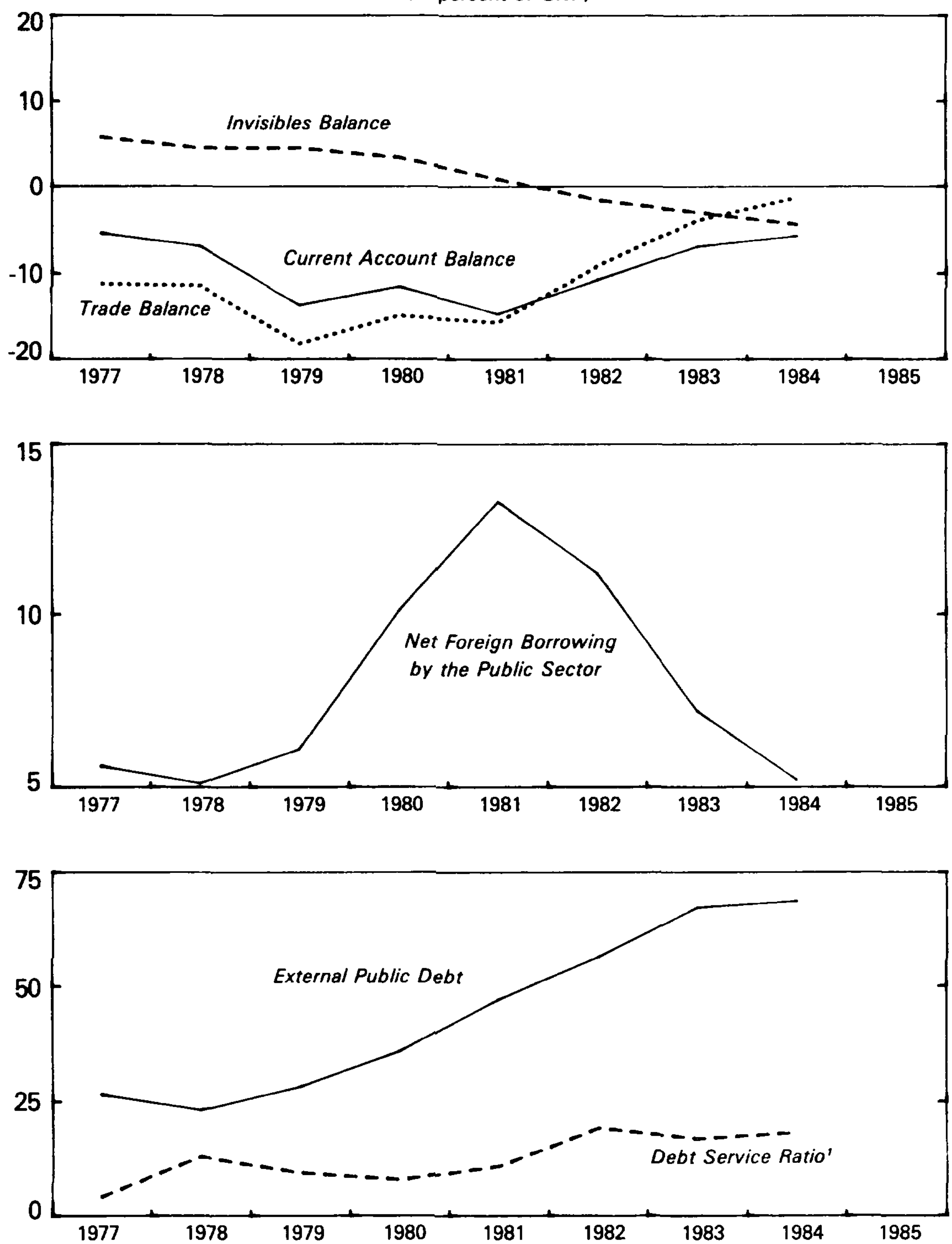
Sources: Central Bank of Ireland, *Quarterly Bulletin;* and IMF, *International Financial Statistics.*

CHART 5

IRELAND

EXTERNAL DEVELOPMENTS

(In percent of GNP)



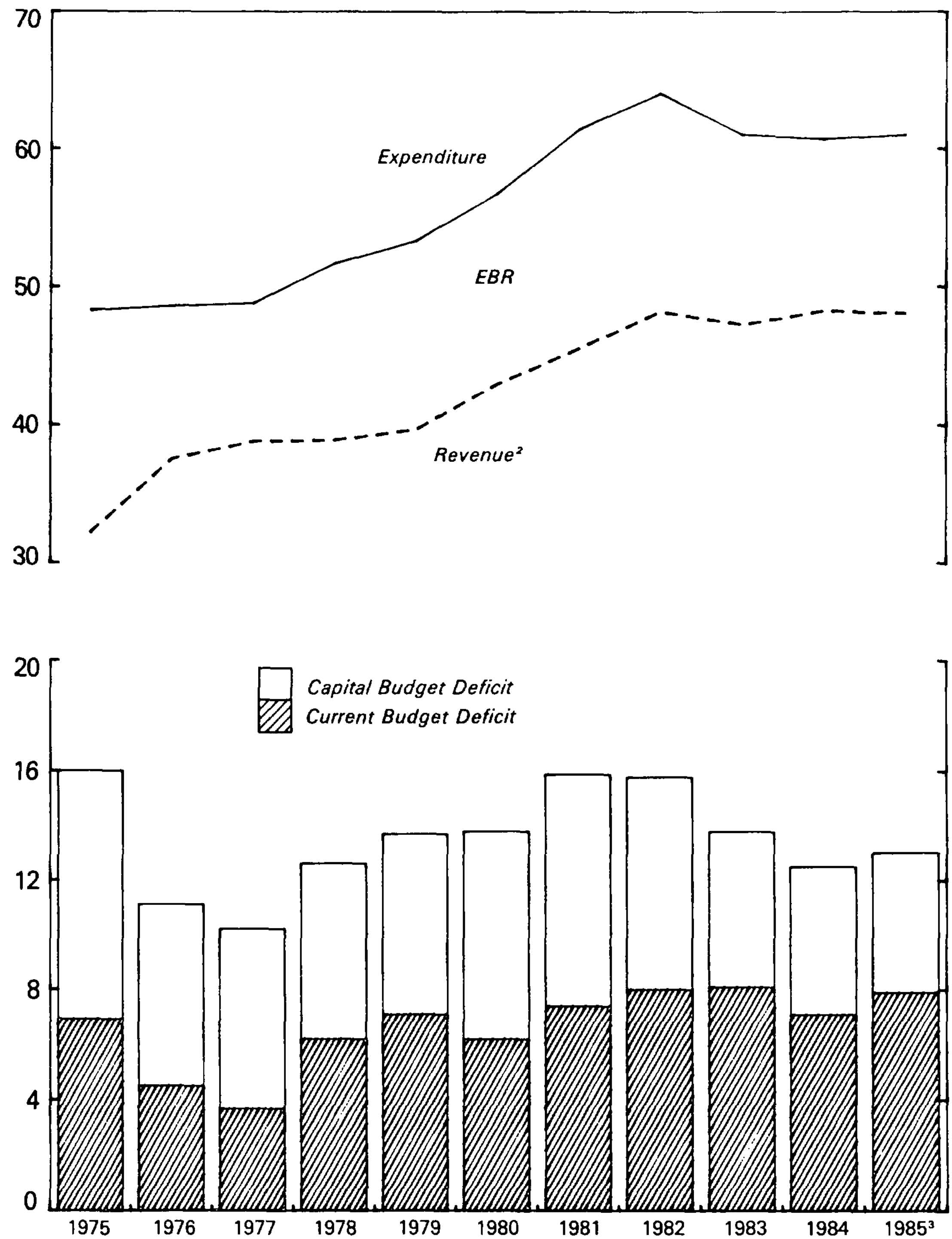
Sources: Central Statistical Office, *National Income and Expenditure,* 1982; and data provided by the Irish authorities.
[1] Ratio to exports of goods and nonfactor services.

CHART 6

IRELAND

CENTRAL GOVERNMENT: EXPENDITURE, REVENUE, AND EXCHEQUER BORROWING REQUIREMENT, 1975-85[1]

(In percent of GNP)



Source: Department of Finance, *Budgets*.

[1] Data since 1983 are on a new budget basis and are not directly comparable with earlier outcomes.

[2] Including capital resources.

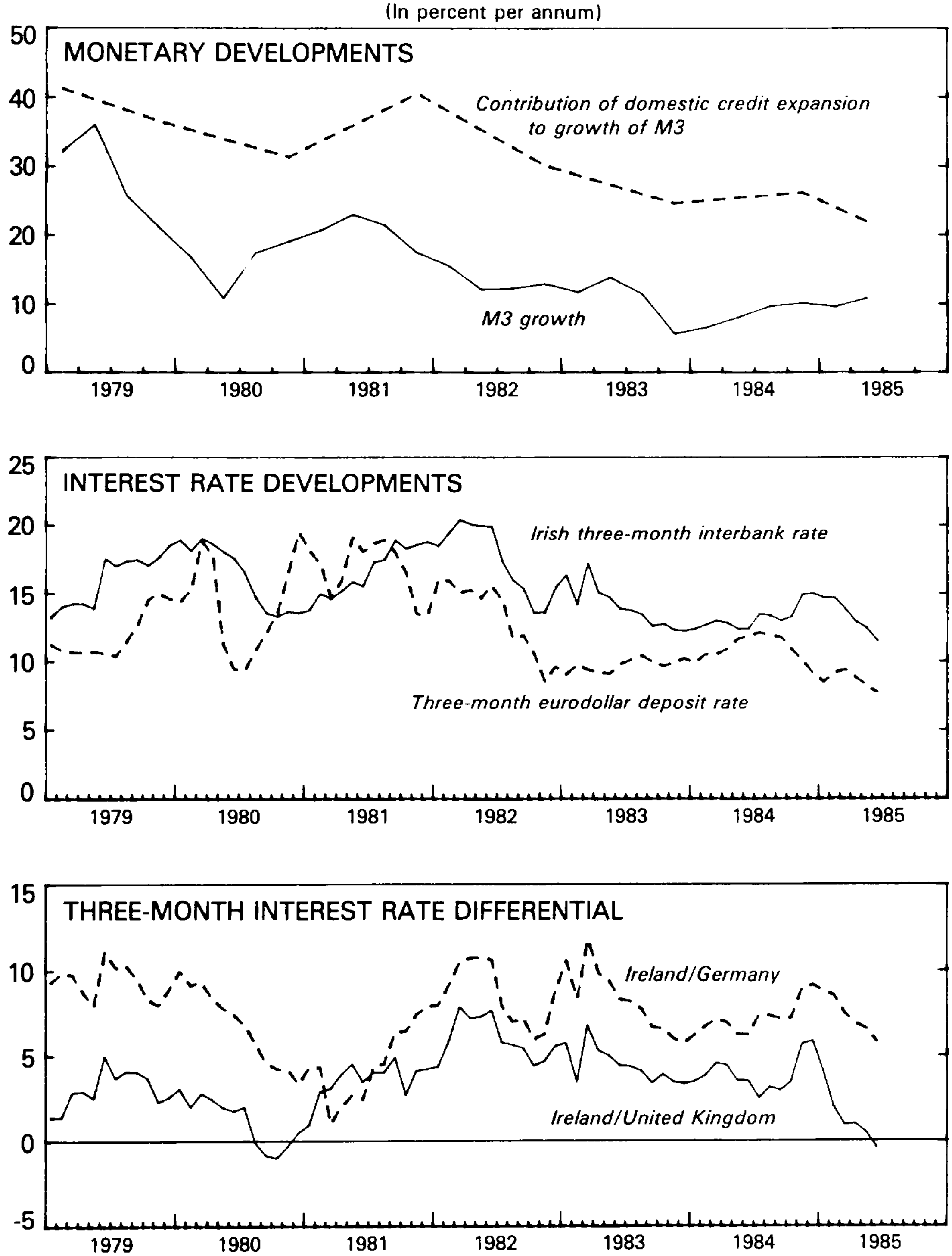
[3] Budget estimates.

CHART 7

IRELAND

INTEREST RATE DEVELOPMENTS

(In percent per annum)



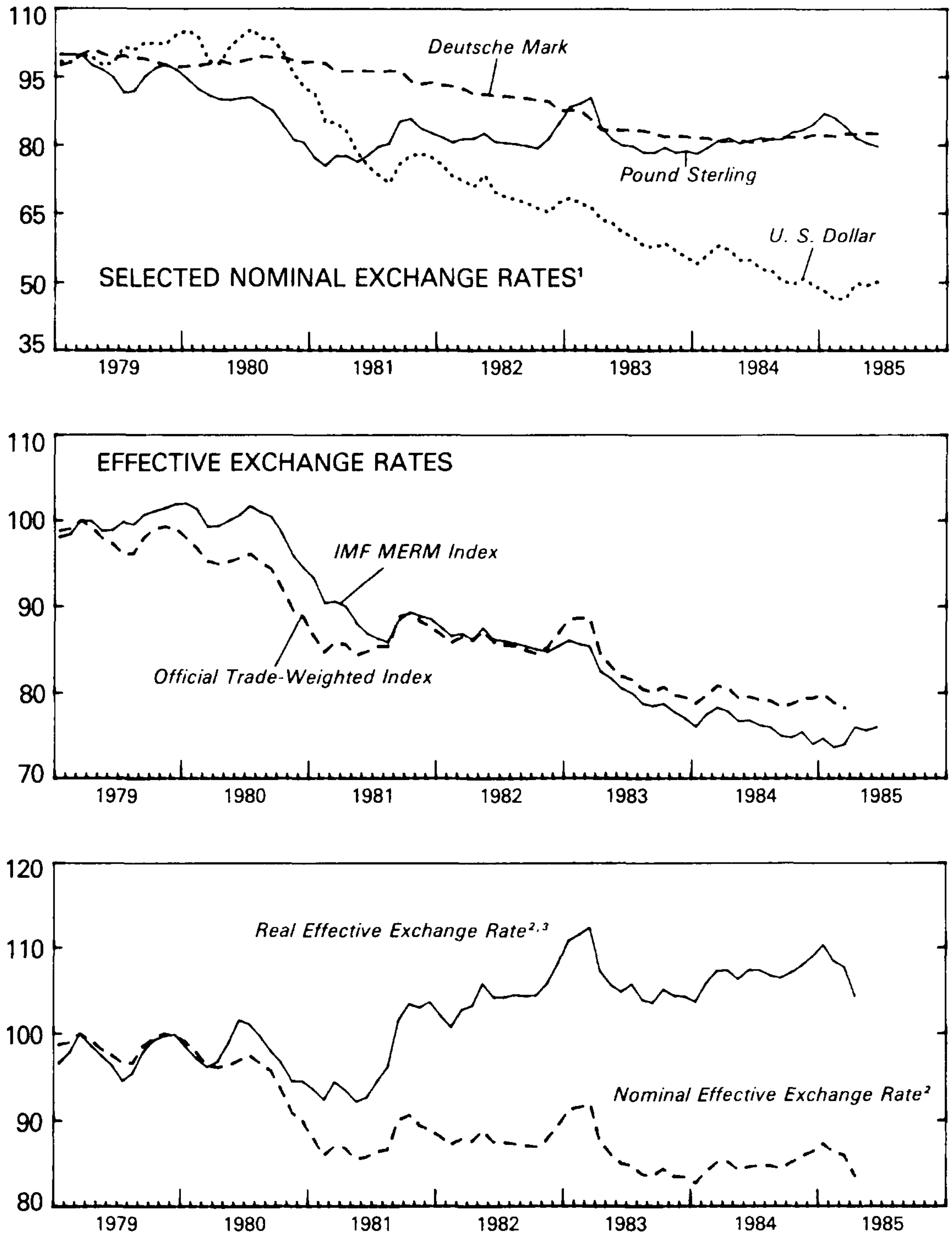
Sources: Central Bank of Ireland, *Quarterly Bulletin;* and IMF, *International Financial Statistics.*

CHART 8

IRELAND

EXCHANGE RATE DEVELOPMENTS

(March 1979 = 100)



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

[1] In units of foreign currency per Irish pound.

[2] Staff estimates, based on 1980 trade weights adjusted for the significance of partner countries in Ireland's export markets.

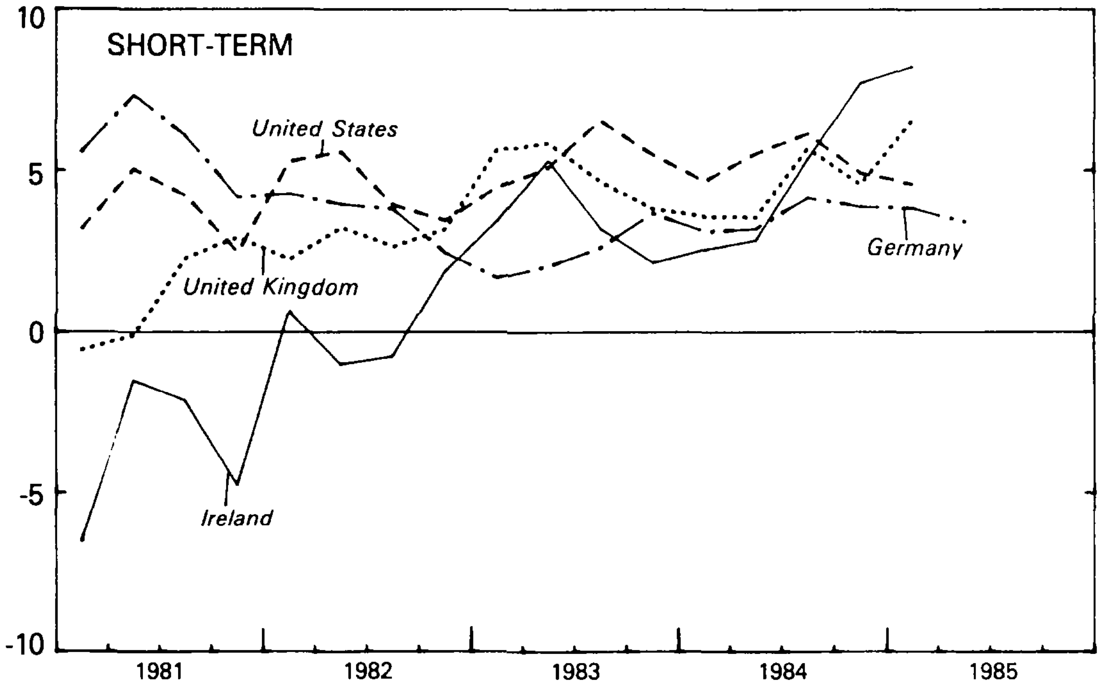
[3] Adjusted for changes in relative consumer prices.

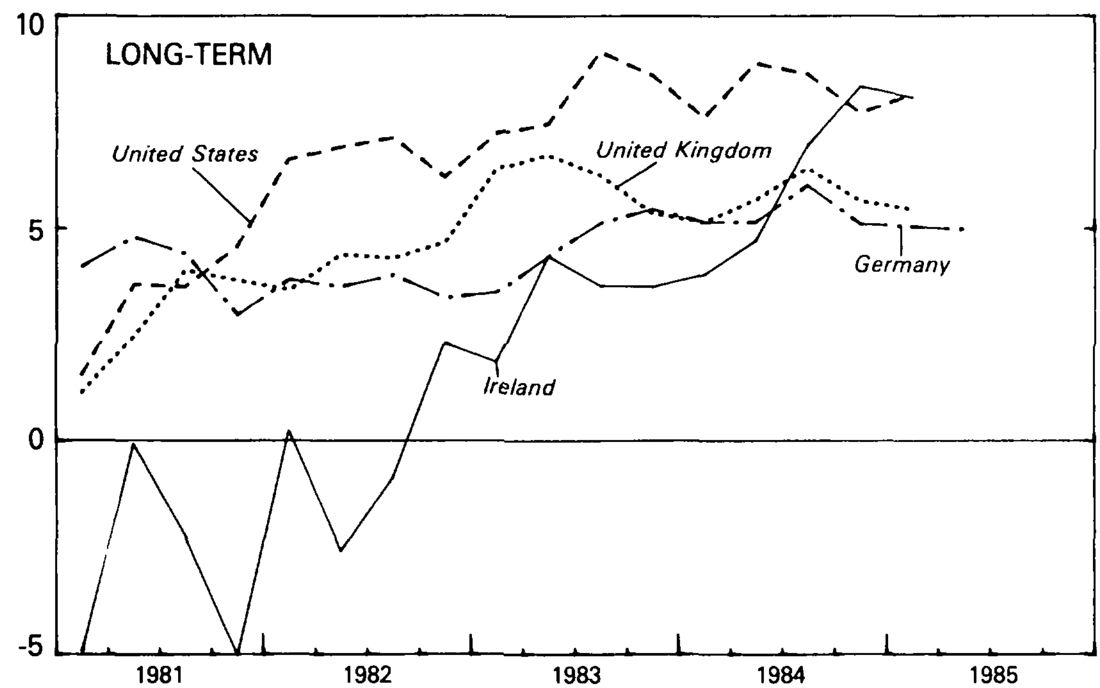
CHART 9

IRELAND

REAL INTEREST RATES[1]

(In percent)





Source: IMF, *International Financial Statistics.*

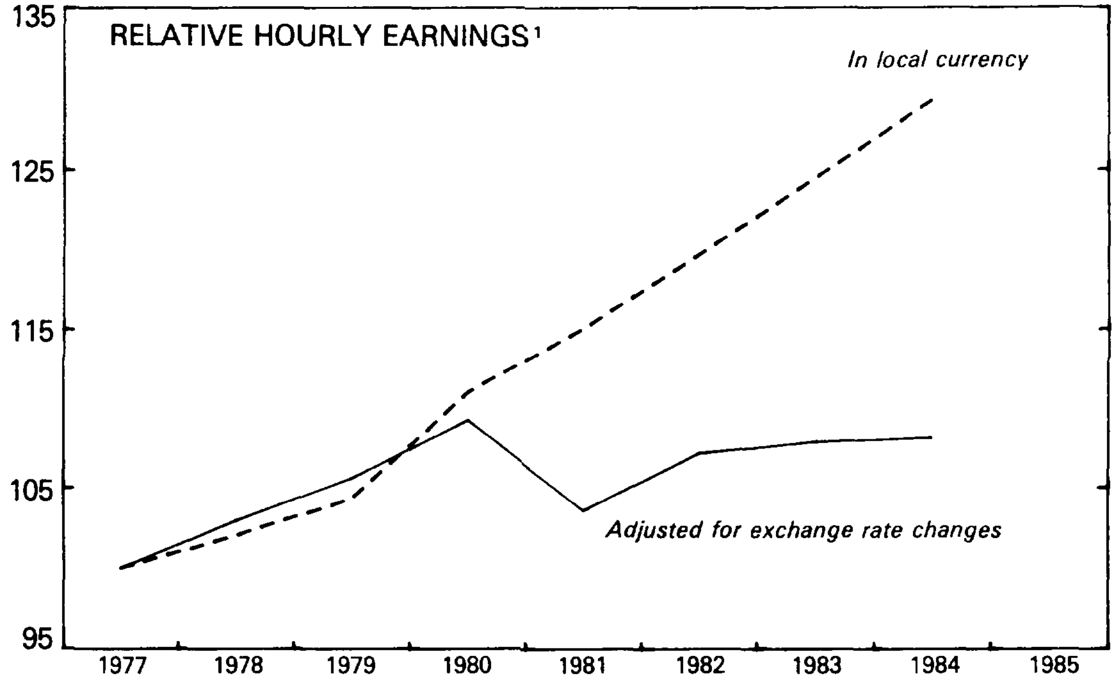
[1] Defined as nominal interest rates deflated by consumer prices.

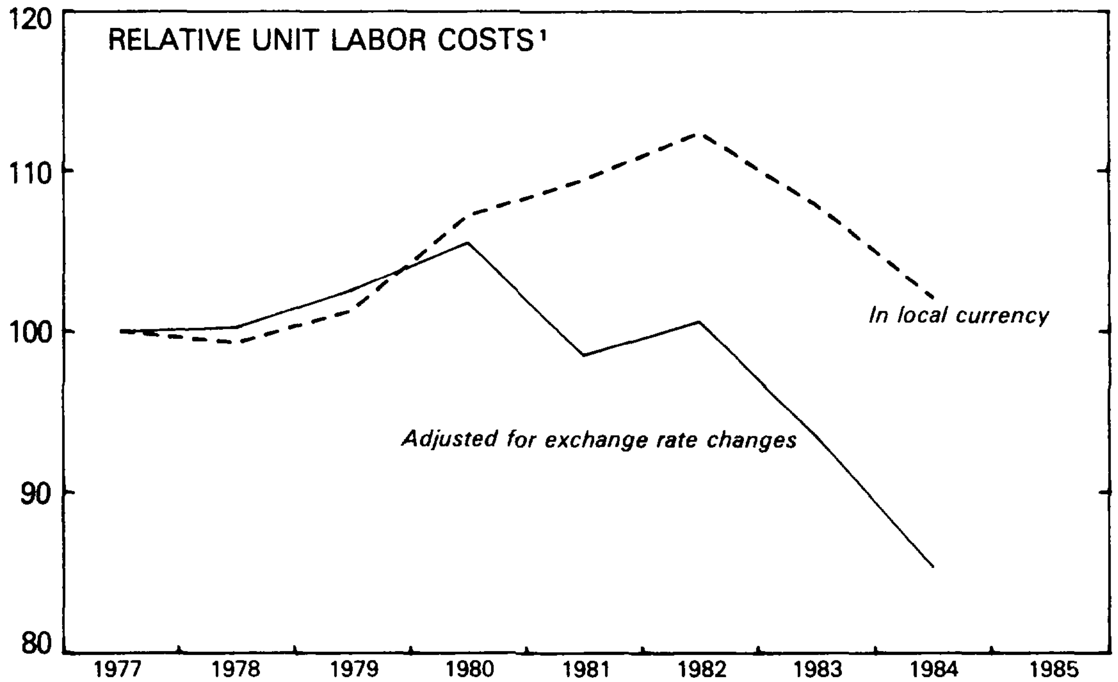
CHART 10

IRELAND

INDICATORS OF COMPETITIVENESS IN MANUFACTURING

(1977=100)



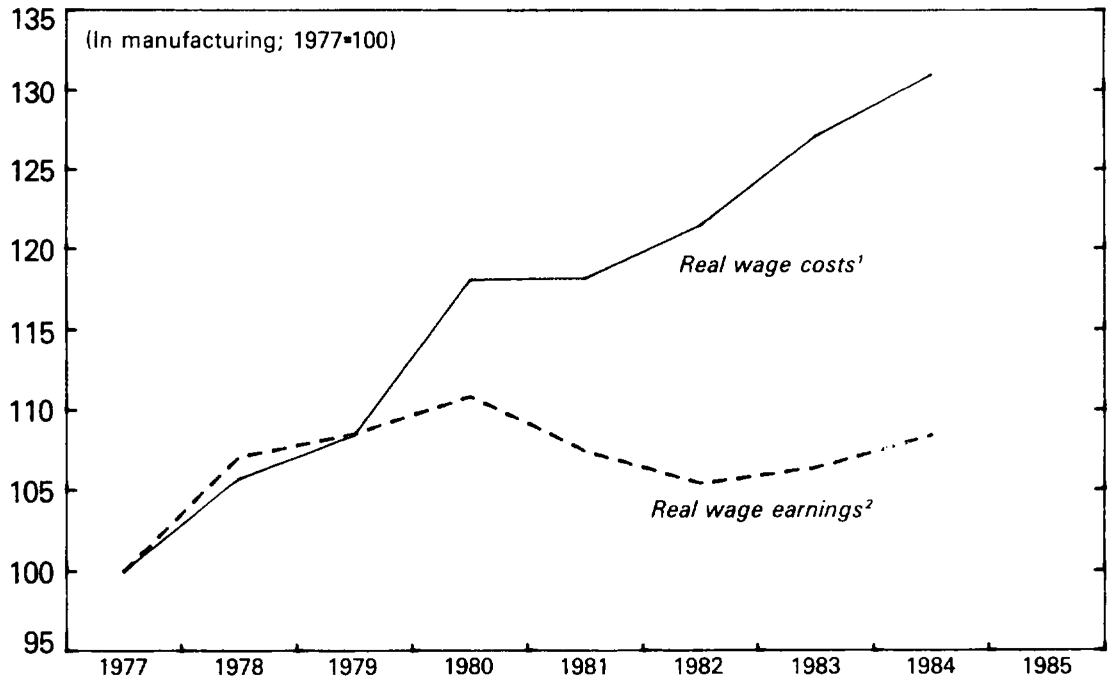


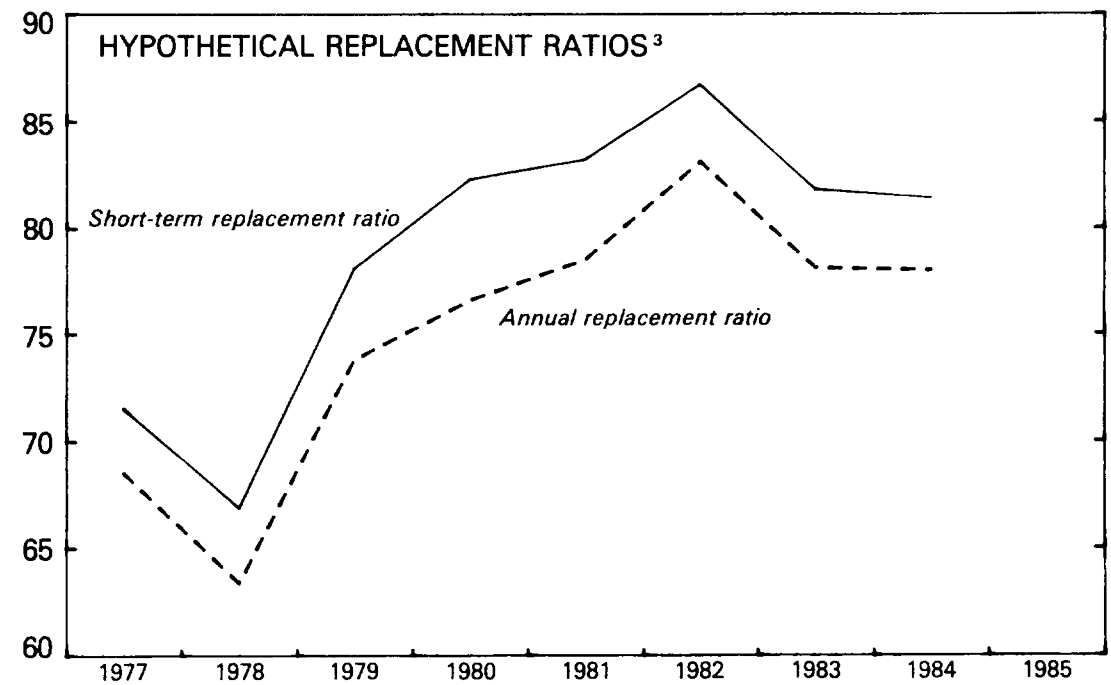
Sources: IMF, *International Financial Statistics*, and Research Department; and data provided by the Irish authorities.
[1]Irish index relative to a weighted average of the corresponding index of Ireland's 14 major trading partners.

CHART 11

IRELAND

REAL WAGE COSTS, REAL WAGE EARNINGS, AND REPLACEMENT RATIOS





Sources: IMF, *International Financial Statistics;* OECD, *Ireland: Economic Survey, 1985;* and data provided by the Irish authorities.
[1]Hourly earnings in manufacturing deflated by output prices.
[2]Hourly earnings in manufacturing deflated by consumer prices.
[3] Ratio of disposable income while unemployed to disposable income while employed for a married man with two children earning the average industrial wage.

Table 2. Ireland: Summary of Current and Capital Budgets

	1981	1982	1983 1/	1984	1985 Budget estimate	1985 1st half-year out-turn
	(In millions of Irish pounds)					
Current revenue	3,973	4,908	5,255	5,952	6,400	2,960
Current expenditure	4,775	5,896	6,340	6,991	7,634	3,773
Current deficit	802	988	1,085	1,039	1,234	813
(In percent of GNP)	(7.6)	(8.2)	(8.2)	(7.2)	(7.9)	(...)
Capital budget deficit	920	957	768	786	785	297
Exchequer borrowing requirement (EBR)	1,722	1,945	1,853 1/	1,825	2,019	1,110
(In percent of GNP)	(16.3)	(16.1)	(13.9)	(12.6)	(13.0)	(...)
Financed by:						
Domestic bank financing	187	228	195	519	...	-778
External borrowing	1,255	1,130	828	770	...	1,229
Direct borrowing	1,285	1,148	793	649	...	937
Domestic nonbank financing	280	587	733	536	...	659
Total central government debt	10,195	12,817	15,754	18,500	...	...
(In percent of GNP)	(96.5)	(106.1)	(118.4)	(128.0)	(...)	(...)
	(In percent of EBR)					
Memorandum items:						
External borrowing	72.8	58.1	47.2	42.2	...	110.7
Domestic bank financing	10.8	11.7	11.1	28.4	...	-70.0
Domestic nonbank financing	16.3	30.2	41.7	29.4	...	59.4

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

1/ Figures adjusted to take into account the transfer of some functions to autonomous bodies and to make them comparable to the outturns in subsequent years. The unadjusted EBR in 1983 amounted to £Ir 1,756 million, financed as indicated in this table.

Table 3. Ireland: Monetary Survey

(End of period data)

	1984 Dec. 1/ In millions of Irish pounds	1981	1982	1983 1/	1984 1/ Mar.	June	Sept.	Dec.	1985 1/ Mar.	May 2/
		Percentage changes from the corresponding period in previous year								
Net foreign assets 3/	-1,136	0.8	1.4	-4.2	4.3	-0.9	-5.8	-4.7	2.1	8.0
Domestic credit, net	11,093	18.0	15.9	12.3	4.8	10.6	14.9	13.6	8.9	3.6
To government	2,961	11.0	34.9	14.4	-7.1	8.7	36.0	30.2	10.3	-6.9
To nongovernment	8,132	19.9	10.8	11.7	8.8	11.2	9.0	8.5	8.4	7.4
Narrow money (M1)	2,020	8.2	7.1	8.6	9.2	7.1	8.4	9.1	0.9	7.9
Broad money (M3)	8,474	17.4	12.9	5.6	6.5	8.0	9.7	10.1	9.6	10.8
		(Percent of M3 in corresponding period of previous year)								
Memorandum items:										
Contribution to growth of M3										
Domestic credit expansion 4/		40.5	30.1	24.7	23.3	26.0	27.9	26.2	21.8	21.9
Net domestic credit		19.3	16.8	14.7	6.1	13.4	18.8	17.2	11.1	4.8
Government, net		2.4	7.4	3.9	-3.2	-2.2	9.9	8.9	2.9	-2.3
Nongovernment		16.9	9.4	10.8	8.4	11.2	8.9	8.3	8.2	7.1
Velocity of circulation 5/ (M3) (in percent)		1.7	1.9	1.8	...	...	...	1.8	...	...

Source: Central Bank of Ireland, Quarterly Bulletin.

1/ Based on new money and banking statistics. The previous format was discontinued in December 1983.
2/ As of May 15, 1985.
3/ Change in NFA as percent of M3 in corresponding period of previous year.
4/ Change in net domestic credit plus net external financing of the Exchequer.
5/ Ratio of nominal GNP to average broad money stock.

Table 4. Ireland: Illustrative Medium-Term External Debt Scenarios

	1984	1987	1990
	(In millions of Irish pounds)		
Base scenario 1/			
Exports 2/	9,742	14,800	21,900
Imports 2/	-9,778	-14,000	-20,300
Investment income, net	-1,609	-2,300	-3,100
Transfers, net	808	900	900
Current account balance	-837	-600	-600
Gross borrowing requirement	1,650	1,600	2,000
External public debt	10,085	13,000	15,700
	(In percent)		
Current account balance/GNP	-5.8	-3.0	-2.7
External public debt/GNP	69.8	71.5	70.5
Net external public borrowing/GNP	5.3	4.5	4.5
Interest payments/GNP	6.2	5.7	5.5
Debt service ratio	18.2	12.5	10.0
Interest payments ratio	9.1	7.0	5.5
Amortization payments ratio	9.1	5.5	4.5
Alternative scenario 3/			
Current account balance/GNP	-5.8	-5.0	-7.0
External public debt/GNP	69.8	74.5	82.0
Interest payments/GNP	6.2	6.0	6.5

Source: Staff estimates.

1/ The main assumptions underlying this scenario are as follows. The projections for 1985 are in line with the forecasts discussed in the text. For the rest of the decade, real GNP in industrial countries is assumed to rise on average by 3 percent per annum, with the inflation rate stabilizing at 4 1/2 percent. The volume of world trade is assumed to rise by 5 1/4 percent per annum, in line with the latest World Economic Outlook. Interest rates in world financial markets (LIBOR on U.S. dollar deposits) are assumed to fall gradually to 8 1/2 percent by 1987 and to stabilize at 8 percent during the rest of the period. Exports of goods and services are assumed to increase in real terms by 9 percent per annum, reflecting, besides the growth in export markets, the expected further increase in export capacity. Real domestic demand is assumed to grow at an average rate of 1 3/4 percent per annum in the period after 1987, with real GNP growth averaging about 2 percent. The growth in the volume of imports of goods and services is related to the growth in total aggregate demand through an assumed elasticity of 1.65. Import and export prices are assumed to rise in line with world prices, and the effective exchange rate is assumed to remain stable. External public borrowing covers the deficit on the current and the private capital accounts, and allows for the maintenance of official reserves at the equivalent of three months of imports. All new borrowings are assumed to be on floating interest rates and to be repayable within ten years, including eight years of grace.

2/ Goods and nonfactor services.

3/ Based on the same assumptions as the base scenario, except for the volume of exports, which is assumed to rise in line with export markets, and world interest rates, which are assumed to be 1/2 a percentage point higher in each year during 1986-90.

Fund Relations with Ireland

(As of end-June 1985; in millions of SDRs)

I. Membership Status

(a) Date of membership: August 8, 1957
(b) Status: Article VIII from February 15, 1961

A. Financial Relations

II. General Department

(a) Quota: SDR 343.4 million
(b) Total Fund holdings of Irish pounds: SDR 223.1 million (65 percent of quota)
(c) Fund credit: none
(d) Reserve tranche position: SDR 120.3 million
(e) Current operational budget: the Irish pound is in the current budget; maximum use is SDR 10 million for purchases and SDR 6.5 million for repurchases

III. Stand-By or Extended Arrangements and Special Facilities: none

IV. SDR Department

(a) Net cumulative allocation: SDR 87.3 million
(b) Holdings: SDR 94.0 million or 107.8 percent of net cumulative allocation
(c) Current designation plan: the Irish pound is included in the current plan to a maximum of SDR 0.5 million

V. Administered Accounts: Not applicable

VIII. Exchange Rate Arrangements

Since March 13, 1979 Ireland has participated in the exchange rate mechanism of the European Monetary System. Under this system, Ireland maintains spot exchange rates in terms of the currencies of the other participants (Belgium, Denmark, the Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands) within margins of 2.25 percent (in the case of the Italian lira, 6 percent) above and below cross rates derived from central rates expressed in ECUs. The central rate of the Irish pound is ECU 1 = £Ir 0.724578.

IX. Last Article IV Consultation

Discussions for the 1984 Article IV consultation were held in Dublin during June 15 to 25, 1984. The Staff Report (SM/84/206, 8/22/84) was discussed by the Executive Board on September 14, 1984 (EBM/84/143). Ireland is on the 12-month consultation cycle.

Ireland--Basic Data

Area and population

Area	70,282 sq. km.
Population (in 1984)	3,535,000
Total labor force (at mid-April 1984)	1,324,000
GNP per capita in 1984 (in SDRs)	4,157

	1983	1976-81	1981	1982	1983	1984 2/	1985 3/
	In percent of GNP	Average 1/	Volume changes (in percent)				
Demand and supply							
Private consumption	64.2	4.7	2.1	-4.9	-3.5	0.5	2.0
Public consumption	21.9	5.2	2.0	4.1	--	-1.4	2.5
Gross fixed investment	24.8	7.1	6.1	-6.1	-7.7	-1.3	-1.0
Of which:							
Machinery and equipment	...	4.8	12.0	2.7	-10.5	4.0	2.5
Stockbuilding 4/	0.6	...	--	1.2	1.3	0.6	-1.5
Total domestic demand	111.5	4.9	3.1	-2.7	-2.8	0.3	--
Exports of goods and services	58.0	8.2	1.8	5.5	10.6	15.7	11.0
Imports of goods and services	60.7	7.9	2.3	-3.1	3.9	8.7	7.0
Foreign balance 4/	-2.7	...	-0.5	5.1	3.8	3.8	3.0
GDP	108.8	4.8	2.9	1.9	0.6	3.8	3.0
Net factor income from abroad	-8.8	...	-0.9	-3.3	-1.4	-2.0	-1.0
GNP	100.0	3.9	2.1	-1.3	-0.7	2.2	2.0
Real GNP adjusted for changes in the terms of trade 5/		2.7	1.5	0.1	1.2	1.0	...
Manufacturing output		4.6	2.6	-0.3	7.5	13.3	8.0
Memorandum item:							
Nominal GNP (in millions of Irish pounds)			10,567	12,079	1,330	14,450	15,550
Employment and unemployment			(Annual percentage changes)				
Total employment 6/			-0.9	0.2	-2.0	-1.3	...
Employment in manufacturing 6/			-2.5	-1.7	-5.6	-3.6	...
Labor force 6/			2.0	1.9	1.0	0.4	...
Unemployment rate (in percent of labor force) 7/			10.1	12.1	14.7	16.3	...
Prices and incomes							
GNP deflator			17.2	15.8	10.9	6.5	5.5
Consumer prices			20.4	17.1	10.4	8.6	5.5
Output prices in manufacturing			16.7	11.9	6.5	7.4	...
Import prices			18.8	7.3	4.7	10.8	...
Nonagricultural wage bill			19.1	13.7	7.7	8.6	7.0
Nonwage incomes 8/			21.5	14.3	17.0	18.3	11.0

Basic data (cont.)	1981	1982	1983	1984 2/	1985 3/
	(Annual percentage changes)				
Average per capita earnings in the public sector 9/	20.0	13.0	10.5	8.0	...
Average hourly earnings in manufacturing	16.4	14.4	11.6	10.6	7.0
Output per man-hour in manufacturing	5.7	5.0	14.2	15.6	11.0
Unit labor costs in manufacturing	10.0	9.0	-2.3	-4.2	-3.5
Real personal disposable income	-0.5	-1.7	-2.3	-1.5	2.0
Personal savings ratio (in percent)	16.8	19.4	20.9	19.4	19.5
Central government accounts	(In millions of Irish pounds)				
Current revenue	3,973	4,908	5,255	5,952	6,400 10/
Current expenditure	4,775	5,896	6,340	6,991	7,634 10/
Capital expenditure, net of capital resources	920	957	768	786	785 10/
Exchequer borrowing requirement	1,722	1,945	1,853	1,825	2,019 10/
(In percent of GNP)	(16.3)	(16.1)	(13.9)	(12.6)	(13.0)
Monetary developments (end of period data)	(Annual percentage changes)				
Money supply (M3)	17.4	12.9	5.6	10.1	...
Credit to the private sector	19.9	10.8	11.7	8.5	...
Credit to Government, net	11.0	34.9	14.4	30.2	...
Domestic credit expansion 11/	40.5	30.1	24.7	26.2	...
Balance of payments	(In millions of Irish pounds)				
Trade balance	-1,698	-1,120	-521	-198	200
Services and transfers, net	103	-196	-404	-639	-875
Of which: Net factor income	-505	-928	-1,183	-1,609	...
Current account balance	-1,595	-1,316	-925	-837	-675
(In percent of GNP)	(-15.1)	(-10.9)	(-7.0)	(-5.8)	(-4.5)
Capital inflows, net	1,603	1,406	1,152	805	...
Of which:					
Public sector	1,437	1,379	968	767	...
Nonbank private sector	45	3	-96	-130	...
Financial institutions	12	132	606	364	...
Net residual	117	-232	-293	-337	...
Overall balance	9	91	227	-32	...
External official reserves (in millions of SDRs)	2,291	2,389	2,534	2,412	3,477 12/
(In months of merchandise imports)	(3.0)	(3.3)	(3.8)	(3.2)	(4.3)

Basic data (cont.)	1981	1982	1983	1984 2/	1985 3/
	(In millions of Irish pounds)				
External public debt	5,100	6,959	9,050	10,085	...
(In percent of GNP)	(48.3)	(57.6)	(68.1)	(69.8)	(...)
Debt service ratio (in percent)	10.8	19.2	17.0	18.2	...
Memorandum items:	(Annual percentage changes)				
Volume of exports	0.8	7.2	12.3	17.8	11.5
Volume of imports	2.1	-3.4	3.1	9.3	7.0
Unit value of exports	16.1	11.1	8.8	8.3	6.0
Unit value of imports	18.8	7.3	4.7	10.8	6.0
Terms of trade	-2.3	3.5	3.8	-1.8	--
Exchange rate developments					
U.S. dollars per Irish pound	-21.4	-12.0	-12.2	-12.9	-13.3 13/
Pound sterling per Irish pound	-9.9	1.9	1.3	-1.1	3.3 13/
Effective exchange rate					
Official trade-weighted index	-8.5	-0.6	-3.3	-4.4	...
MERM	-10.8	-3.0	-5.9	-6.0	-2.8 13/
Real effective exchange rate 14/	-1.1	7.6	2.3	0.2	1.7 15/
Relative unit labor costs 16/					
Relative to 14 industrial countries	-6.6	2.1	-7.1	-8.7	...
Relative to EMS partners 17/	0.8	2.7	-8.7	-5.3	...

Sources: Department of Finance, Current Economic Trends, June 1985; Central Bank of Ireland, Annual Report, 1985; IMF, International Financial Statistics; data provided by the Irish authorities; and staff estimates.

1/ Five-year compound annual average.
2/ Provisional.
3/ Forecast.
4/ Contribution to growth of GNP.
5/ By deflating exports of goods and services by the deflator of imports of goods and services.
6/ At mid-April.
7/ Average registered unemployment in percent of the labor force in mid-April.
8/ Trading profits, professional earnings, interest, dividends, and rents.
9/ Inclusive of overtime, back-pay, and social insurance contributions.
10/ Budget estimates.
11/ Change in net domestic credit plus net external financing of the Exchequer, as a percentage of M3 at the end of the previous year.
12/ As at end-June, with gold valued at SDR 35 per ounce.
13/ Average year-on-year change during the first half of 1985.
14/ Staff estimates (based on 1980 trade weights adjusted for the significance of partner countries in Ireland's export markets), adjusted for changes in relative consumer prices.
15/ Average year-on-year change during the first five months of 1985.
16/ Staff estimates, adjusted for exchange rate changes.
17/ Excluding the United Kingdom, which does not participate in the exchange rate arrangements of the EMS.

Ireland - Statistical Issues

1. Outstanding Statistical Issues

a. Monetary aggregates

The data for commercial banks and other financial institutions published in IFS are uncurrent. For the commercial banks this reflects a major change, initiated by the Irish authorities, in the collection of monetary aggregates whereby the Associated Banks' reports have been changed to a residency basis and a much revised, and more detailed, set of call report forms for collecting data from financial institutions in Ireland has been introduced. On the basis of these new call report forms, it is intended to introduce major changes in the IFS data, including the introduction of a Banking Survey.

In February 1985, the Bureau of Statistics sent the Central Bank of Ireland proposals for revising monetary aggregates for the country page in IFS, together with copies of revised Bureau report forms, which are at present being completed by the Central Bank for submission to the Bureau in the near future.

b. Government finance

The 1984 Government Finance Statistics Yearbook includes central government data on revenues and expenditures by economic type, but data have not yet been compiled for the following items: (i) the functional classifications of expenditures; (ii) lending minus repayments; (iii) capital expenditure; and (iv) financing and outstanding government debt by type of holder and by type of instrument.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Ireland in the July 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Ireland, which during the past year have been provided on a timely basis, although the currentness of some of the data needs to be improved.

Status of IFS Data

			Latest Data in July 1985 IFS
Real Sector	- National Accounts		1983
	- Prices	CPI	Feb. 1985 1/
		WPI	Nov. 1984
	- Industrial production, seasonally adjusted		Dec. 1984
	- Employment: Manufacturing		Q4 1984
	- Earnings (weekly wages)		Q3 1984

Government Finance	- Deficit/Surplus		Q1 1985
	- Financing		Q1 1985
	- Debt		n.a.
Monetary Accounts	- Central Bank		February 1985
	- Deposit Money Banks		February 1983
	- Other Financial Institutions		February 1983
External Sector	- Merchandise Trade:	Values	March 1985
		Prices	January 1985
	- Balance of Payments		1982
	- International Reserves		May 1985
	- Exchange Rates		May 1985

1/ Compiled and published for February, August, and November of each year.