Financial Emergency Measures in the Public Interest Act 2013 (No. 18 of 2013)

Annual review and report to the Houses of the Oireachtas by the Minister for Public Expenditure and Reform under section 12 of the Act

June 2016

I – Introduction and Background

1. Under section 12 of the Financial Emergency Measures in the Public Interest Act 2013 (No. 18 of 2013) the Minister for Public Expenditure and Reform is obliged, before 30 June 2016, and in respect of the following four Acts;

   - Financial Emergency Measures in the Public Interest Act 2009 (No. 5 of 2009),
   - Financial Emergency Measures in the Public Interest (No. 2) Act 2009 (No. 41 of 2009),
   - Financial Emergency Measures in the Public Interest Act 2010 (No. 38 of 2010),
   - Financial Emergency Measures in the Public Interest Act 2013 (No. 18 of 2013),

   (a) to carry out a review of the operation, effectiveness and impact of the relevant Acts, having regard to the overall economic conditions in the State and national competitiveness,

   (b) consider whether or not any of the provisions of the relevant Acts continue to be necessary having regard to the purposes of those Acts, the revenues of the State and State commitments in respect of public service pay and pensions,

   (c) make such findings as he or she thinks appropriate consequent on the review and consideration, and

   (d) cause a written report of his or her findings resulting from the review and consideration to be prepared and laid before each House of the Oireachtas.

2. The Financial Emergency Measures in the Public Interest Act 2009 introduced a number of measures, the principal of which was the introduction of a new deduction from the remuneration of pensionable public servants, which is known as the Pension-Related Deduction (PRD); the percentage reduction rates applied were subsequently amended in section 13 of the Social Welfare and Pensions Act 2009. In addition, the 2009 Act contained measures allowing public service bodies to reduce the professional fees paid by them to external service providers, implementing changes in the early child care supplement and facilitating the payment of grants under the Farm Waste Management

Scheme on a phased basis. With respect to the professional fees reduction measure, section 9(13) of the Act provides that the Minister for Health may review the operation, effectiveness and impact of the amounts and rates of payments to health professionals fixed by regulation under the Act and consider the appropriateness of same.

3. The purpose of the Financial Emergency Measures in the Public Interest (No. 2) Act 2009 was to provide for the reduction of the remuneration of public servants (including members of the Houses of the Oireachtas and certain Office Holders), and to provide for related matters. The Act was amended by the Financial Emergency Measures in the Public Interest (Amendment) Act 2011. The primary purpose of this Act was to apply the terms of the Financial Emergency Measures in the Public Interest Acts 2009 to serving members of the judiciary, and to a military judge once appointed. The 2011 Act also made provision for the reduction of salary rates for newly appointed members of the judiciary and to further increase the level of salary reductions for certain Office Holders.

4. The principal purpose of the Financial Emergency Measures in the Public Interest Act 2010 was to introduce a reduction in public service pension costs, by way of the introduction of the Public Service Pension Reduction (PSPR). It also provided for a reduction in pay rates of members of the Government and a reduction to the National Minimum Wage.

5. The Financial Emergency Measures in the Public Interest Act 2013 implemented a further pay reduction for public servants earning annual salaries of more than €65,000 and effected a reduction in public service pensions over €32,500.

6. The Financial Emergency Measures in the Public Interest Act 2015 commenced the gradual, fiscally sustainable, unwinding of certain measures contained in the earlier Acts. The primary purpose of the 2015 Act is to ameliorate the impact of the reductions provided for under the Financial Emergency Measures in the Public Interest Acts 2009-2013 through a series of amendments to the relevant Acts.

7. In understanding the purpose and policy underpinning these Acts reviewed here as approved by the Oireachtas, and consequently the context of the review, the preambles to the Acts should be noted. In this connection text from the preamble to the Financial Emergency Measures in the Public Interest (No. 2) Act 2009, the Financial Emergency

Measures in the Public Interest Act 2013, and the Financial Emergency Measures in the Public Interest Act 2015 is set out below and may be considered representative:

Extract from the Financial Emergency Measures in the Public Interest (No. 2) Act 2009

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

AND WHEREAS as a consequence a serious deterioration in the revenues of the State has occurred and there are significant and increasing State commitments;

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

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

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

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

Extract from the Financial Emergency Measures in the Public Interest Act 2013

"WHEREAS budgetary and fiscal measures have been taken by the State since 2009 to address a serious disturbance in the economy and a decline in the economic circumstances of the State that have occurred;

AND WHEREAS it is necessary for the State to achieve further significant savings in its expenditure, both directly and indirectly, on remuneration and in its expenditure on public service pensions as a contribution to the reduction of the shortfall between revenue and expenditure that is needed to put debt on a downward path;

AND WHEREAS it is necessary for the State to take measures as part of remedial action to maintain the State's path toward correcting the excessive deficit by 2015 in line with the recommendation to that effect of the Council of the European Union (Council Recommendation with a view to bringing to an end the situation of an excessive deficit in Ireland of 7 December 2010)"

Extract from the Financial Emergency Measures in the Public Interest Act 2015

"WHEREAS economic growth has resumed and the State's international competitiveness has improved and a significant improvement in the fiscal circumstances of the State has occurred;

AND WHEREAS it remains necessary to retain firm control of current Exchequer expenditure so as to ensure ongoing access to international funding and improve competitiveness, while taking into account the continuing risks to the public finances which remain, and the need to meet the State's commitments to have a prudent fiscal policy under the Stability and Growth Pact and the Fiscal Compact;

AND WHEREAS the reductions in the remuneration and superannuation of public servants and former public servants effected by legislation enacted in the last 6 years have contributed substantially to improvements brought about in the public finances and it is equitable to implement a partial and phased reversal of those reductions"

8. This report is carried out in accordance with section 12 of the Financial Emergency Measures in the Public Interest Act 2013 and is in respect of the period July 2015 to June 2016.

9. The sections which follow review the overall economic conditions in the State, national competitiveness and Exchequer commitments in respect of public service remuneration and pensions, and represent my findings in the light of that review in accordance with section 12 of the 2013 Act.

II - Economic Context

10. The Irish economy experienced an extremely sharp downturn in the years from 2007 to 2010. The peak-to-trough decline in real GDP was 11 per cent over this period. Sharp declines in investment (23 per cent) and personal consumption (7 per cent), in conjunction with the slowdown in our major trading partners, were the primary reasons for this unprecedented contraction in economic activity.

11. Prior to this (between 2000 and 2008), the Irish economy had experienced a significant loss in competitiveness reflecting domestic cost and price developments which resulted in a sharp moderation in export growth. During that period, pay increases exceeded productivity growth on an economy wide-basis.

12. This loss of competitiveness has been reduced in the years since 2009. Prices and wages while starting from a high base have risen at rates slower than in trading partners. Actual and nominal adjustments in wages seen over the past few years are also helping to restore competiveness.

13. The labour market was particularly affected by the economic downturn. Although employment has since returned to growth, the peak-to-trough decline in employment was just over 15 per cent. The seasonally adjusted rate of unemployment peaked at just over 15 per cent in February 2012 having been as low as 5 per cent in early 2008. In May 2016, the unemployment rate was 7.8 per cent. However, employment in the first quarter of 2016 still remained 8 per cent below its peak.

14. The Irish economy returned to moderate growth in 2010, and annual GDP growth averaged 1.1 per cent between 2010 and 2013. While positive, this was well below the potential growth rate of the economy. The recovery has strengthened in recent years, with growth of 5.2 per cent recorded in 2014 and first estimates indicating growth of 7.8 per cent last year. The expansion in economic activity, initially led by the exporting sectors, has broadened with domestic demand now also making a significant contribution.

15. While an economic recovery is well under way, vulnerabilities remain. Domestically, notwithstanding recent improvements, levels of private debt remain elevated, which may prompt households and firms to increase the pace of deleveraging over the medium-term.

Ireland's highly concentrated industrial base represents another recurring risk facing the economy. As a result, output and employment are exposed to firm and sector-specific shocks. Internationally, the level of uncertainty is higher than at any stage since the height of the crisis. While recent improvements in competitiveness have been beneficial, it is important to point out that as a small open economy, Ireland is particularly susceptible to external risks including the following:

a) The Irish economy is vulnerable to weaker-then-expected trading partner growth which could adversely affect exports, inward investment and result in lower economic activity.

b) In particular, growth in Emerging Market Economies (EMEs) has disappointed in recent quarters and any sharper-than-assumed slowdown in these regions could pose a significant headwind for the global economy.

c) The Irish economy is particularly exposed to the UK's decision to leave the European Union. In the short-term, increased uncertainty and volatility in the financial markets could undermine confidence while the depreciation of Sterling will lead to a loss of competitiveness. Irish SMEs are particularly vulnerable as they have lower profit margins and are more dependent on the UK as an export market.

d) Moreover, the decision to leave represents a shock to the UK, EU and World economy. Over the medium-term, research indicates that the decision will lower UK GDP which would lead to reduced demand for Irish exports and result in lower economic activity in Ireland relative to baseline.

e) A prolonged period of excessively low inflation would harm aggregate demand in many advanced economies, and ultimately could restrain the pace of growth in Ireland.

f) As a net energy importer, a more rapid than anticipated rebound in oil prices would reduce consumer spending and lower corporate profitability in Ireland.

III - Budget Context

16. The State's public finances, in particular tax receipts, have been very severely affected by the sharp contraction in economic activity.

17. Through the early part of the previous decade, net voted expenditure broadly tracked growth in taxation. However, importantly, much of this growth in taxation was driven by an unsustainable increase in transitory taxes. From 2007 on, with the collapse of the property market, a significant gap emerged between revenue and expenditure. Exchequer tax revenue fell 33 per cent, from €47 billion to €32 billion, by 2010. At the same time, net voted expenditure rose to €47 billion over the same period.

18. Since mid-2008, very significant action has been taken to tackle the imbalances in the public finances. A series of "across the board" revenue-raising and expenditure-reducing measures have been introduced. These measures have affected all sectors of society. In addition to the reductions in public service pay and pensions, programme expenditure, capital investment, and certain social welfare rates were reduced. There has also been a significant widening of the tax base with the introduction of the USC and Local Property Tax while income, capital, inheritance, indirect, carbon, pensions and property related taxes were all increased since the adjustment process began. In addition, the tax system has been restructured so that it is based on more stable and less cyclical sources of tax revenue.

19. Consistent achievement of fiscal targets combined with significant structural reforms have facilitated Ireland's correction of the excessive deficit last year. However, Ireland is still recording a headline deficit. Moreover, the rules of the preventive arm of the Stability and Growth Pact require improvements in the structural budget balance each year until the Medium Term Budgetary Objective, a structural deficit of 0.5 per cent of GDP is achieved. This in turn can only be delivered by fiscal prudence, and avoiding excessive increases in expenditure or tax cuts.

20. While tax revenues continue to show year-on-year improvement, tax revenues in 2015 were still €1.65 billion below the 2007 level. Ireland must continue to reduce the gap between revenue and expenditure, and this will represent a continuing challenge.

21. Furthermore, Ireland's success in the international debt markets is partly based on the expectation that Ireland will continue to reduce its deficit and debt levels and manage its public finances in a prudent manner.

22. The Excessive Deficit Procedure Returns published in April 2016 showed the headline General Government Deficit in 2015 was 2.3 per cent of GDP, or €4.9 billion. This equates to Ireland borrowing over €13.5 million per day, over and above the revenue collected, to fund expenditure commitments. This ongoing gap between revenues and expenditure is not sustainable and is being reduced in line with our obligations under the preventive arm of the Stability and Growth Pact. Forecasts for 2016 in the Summer Economic Statement point to a General Government Deficit of 0.9 per cent of GDP, or €2 billion. These projections however are predicated on the continued operation of the Financial Emergency Measures in the Public Interest Acts 2009-2013 as ameliorated by the Financial Emergency Measures in the Public Interest Act 2015.

23. General Government Debt measures the total debt of the State and is used for comparative purposes across the European Union. At end-2015 General Government Debt was estimated to have been €201 billion or 93.8 per cent of GDP. It is expected that the level of nominal debt will increase by some €7.5 billion over the next three years, although the ratio of debt-to-GDP is expected to fall to 81.0 per cent of GDP as a result of strong GDP growth. Carrying this high level of debt limits the ability of the public finances to cope with possible external stocks to the economy. The implementation of continued budgetary prudence coupled with growth friendly economic policies, can reduce the debt levels to a lower, safer level over the coming years.

24. While the short-term impact of the Brexit vote remains to be seen, if any major changes to the fiscal position emerge, there could be implications over the medium term for the General Government Deficit, the structural balance and, potentially, for the level of fiscal space that could be used. We will monitor developments closely, however, we remain committed to adhering to the fiscal rules of the Stability and Growth Pact.

25. In the context of the above, finite resources must be allocated to competing societal demands. In 2015 the pay and pensions share of gross voted expenditure is 33%. Unwinding of the Financial Emergency Measures in the Public Interest Acts must reflect an appropriate share of the available fiscal space – balancing competing demands

including for additional public service numbers and increased Government spending on other expenditure programmes. The Lansdowne Road Agreement provides an appropriately phased and fiscally sustainable mechanism for accommodating pay restoration within a framework of additional expenditure requirements.

IV – Cost of Public Service Remuneration

26. In 2009 the gross Exchequer pay bill was €17.514 billion[1]. The Financial Emergency Measures in the Public Interest Act 2009 implemented a Pension-Related Deduction (PRD) on the wages and salaries of pensionable public servants. Across all sectors of the public service, the full year saving of the deduction was €900 million per year. The 2009 (No. 2) Act provided the legislative basis necessary to facilitate a reduction in the gross pay bill cost of public servants (Exchequer funded and local government) by some €1 billion in 2010 through reductions in the remuneration of public servants of between 5 per cent and 20 per cent effective from 1 January 2010. In addition, the Financial Emergency Measures in the Public Interest Act 2013 implemented a further pay reduction for public servants earning annual salaries of over €65,000, and also implemented a reduction in public service pensions over €32,500. The pay reduction to those earning over €65,000 has delivered approximately €210 million in savings.

27. As a consequence the gross Exchequer pay bill (which does not reflect the savings from the Pension-Related Deduction) reduced to €16.0 billion in 2010, €15.7 billion in 2011, €15.3 billion in 2012, €15.1 billion in 2013 and €14.7 billion in 2014. This amounts to a reduction of €2.8 billion over the 2009 figure of €17.5 billion. When account is taken of the Pension-Related Deduction, the reduction amounts to some €3.7 billion over the same period. This has been achieved primarily through the reductions applied under the Acts, supported by a reduction in the number of serving public servants together with other cost reduction and productivity measures.

[1] The Exchequer pay bill does not include the pay bill for public servants in local government or those paid from the Central Fund. The Act applied to the pay rates of those public servants, and savings were therefore also achieved in those costs.

28. The continued operation of the provisions of the Acts has allowed for targeted recruitment in 2015 and 2016 to fill critical gaps in public service numbers, due to the recruitment moratorium, and meet additional staffing requirements in frontline services related to demographic change, for example teachers. In total since Q4 2013, the Government has approved the recruitment of an additional 18,100 public servants to meet demands for enhanced public service delivery. These include 4,300 teachers, 1,500 Special Needs Assistants, 1,700 nurses and over 1,000 consultants/doctors/dentists.

29. Improvements in the public finances also provided the resources necessary to begin the first phase of unwinding the provisions of the Financial Emergency Measures in the Public Interest Acts through the enactment and implementation of the Financial Emergency Measures in the Public Interest Act 2015. This Act gave effect to the terms of the Lansdowne Road Agreement which the overwhelming majority of public servants have accepted and subscribed to. Under the terms of the Agreement, €267 million is included in the 2016 paybill for ameliorating the impact on public service pay of the previous Acts.

30. As a result of the necessary increase in numbers and the provisions of the Financial Emergency Measures in the Public Interest Act 2015, the provisional outturn for the Exchequer paybill in 2015 is €15.1 billion, while the estimate for 2016 is €15.68 billion. Notwithstanding the amelioration measures provided for under the 2015 Act, the 2016 Estimate is predicated on the continued operation of the pay reductions under the 2009 (No. 2) Act and the further reductions to the pay of higher paid public servants, provided for by way of amendment to the 2009 (No. 2) Act under the Financial Emergency Measures in the Public Interest Act 2013. It is also dependent on the Pension-Related Deduction (PRD), as levied on the wages and salaries of pensionable public servants under the 2009 Act as amended.

31. If these provisions were repealed with immediate effect, the cost to the Exchequer would be an additional €1.8 billion in pay restoration (above the 2016 allocation for the implementation of FEMPI 2015 amelioration). Pay restoration of this magnitude in one budget year is unsustainable as it would: exceed available additional resources; violate the terms of EU Stability and Growth Pact; broaden the deficit; increase the national debt; and result in reduced shares of Government Expenditure for capital investment and programme interventions. By contrast the phased approach to unwinding the provisions of the Financial Emergency Measures in the Public Interest Acts allows for strong fiscal

planning, with dedicated resources ring-fenced within multi-annual expenditure ceilings, without compromising service delivery or capital investment. This provides greater certainty in Budget preparation, as the cost of pay and pensions restoration can be balanced against other urgent demands for Exchequer funding, including funding the recruitment of additional public servants.

V – Cost of Public Service Pensions

32. The 2016 estimate for the Exchequer pension bill is estimated at €2.55 billion in net terms, a decrease of €40 million on the 2012 outturn of €2.59 billion. This decrease is due to the large number of retirements in 2012, driven by the expiry in February of that year of a "grace period", during which pension awards were shielded from the downward impact which the 2010 pay reductions would otherwise have had on retirement lump sums and new pensions.

33. Underlying cost-increasing trends, notably improvements in life expectancy and connected demographic factors, will continue to challenge the financing of public service pensions. In particular, the expansion of the public service throughout the 1970s will lead to a large cohort of retirements in the current decade. In this context the launch at the start of 2013 of a new career-average pension scheme for new-joiner public servants, known as the Single Public Service Pension Scheme, will be important in curbing upward cost pressures over the longer-term.

34. The Public Service Pension Reduction (PSPR), as provided for in the Financial Emergency Measures in the Public Interest Act 2010, and selectively increased on all public service pensions over €32,500 under the Financial Emergency Measures in the Public Interest Act 2013 played a key role in dampening overall public service pension costs at an important time. Estimated full year savings from the measure were €135 million. The Financial Emergency Measures in the Public Interest Act 2015, provides for a €30 million amelioration of the PSPR in 2016. Further amelioration of the PSPR to be implemented in 2017 and 2018 under the Financial Emergency Measures in the Public Interest Act 2015, will remove significant numbers of pensioners (approx. 65,000) from the application of

the measure. By 2018, only approx. 25,000 public service pensions, representing the top 20% high value pensions, will be impacted by PSPR. For 2016, there will be a return of €400 to most PSPR-impacted pensioners.

VI – Impact of the Financial Emergency Measures in the Public Interest Act 2015

35. As detailed above the terms of the Lansdowne Road Agreement are being implemented through the Financial Emergency Measures in the Public Interest Act 2015. This agreement extends the terms of the existing Haddington Road Agreement to September 2018, while securing an Industrial Relations framework that will foster and support further productivity and change at the level of the workplace.

36. The provisions of the Financial Emergency Measures in the Public Interest Act 2015 partially unwind the pay reduction measures imposed on public servants and are prudent and sustainable in the fiscal space currently available to Government. The estimated overall gross cost of these pay measures (inclusive of the previously committed costs attributable to the Haddington Road Agreement) in each year of the Agreement is €267 million in 2016, €290 million in 2017, and €287 million in 2018 or a total of €844 million by 2018 of which €278 million is attributable to the pre-existing Haddington Road Agreement commitments. This should be compared to public service pay bill savings of €2.1 billion, achieved as a direct result of pay reductions under the FEMPI legislation.

37. The provisions of the Financial Emergency Measures in the Public Interest Act 2015 also allow for the amelioration of the Public Service Pension Reduction (PSPR) as it applies to the pensions of public servants. The cost of the measures is estimated at some €30 million per annum or a full year cost of €90 million to end 2018. The first phase of the amelioration was implemented in January 2016.

As required under the legislation, measures applied to contracted Health Professionals and certain other groups under section 9 of the Financial Emergency Measures in the

Public Interest Act 2009 are also being considered in the context of the overall unwinding of FEMPI legislation.

VII – Operation, Effectiveness and Impact of the Acts Reviewed

38. I am satisfied that the Acts reviewed here have operated effectively since their inception and that they continue to do so. They have made and continue to make a significant contribution to the ongoing programme of fiscal consolidation required to stabilise the public finances and bring about the necessary improvement in Ireland's external competitiveness. The phased amelioration of the impact of the relevant Acts as provided for by the Financial Emergency Measures in the Public Interest Act 2015 allows for appropriate fiscal planning to ensure that restoration of pay, pensions and other reductions is accomplished in a sustainable manner without jeopardising the State's finances.

VIII – Consideration of the Need to Continue the Provisions in the Acts Reviewed

39. The consistent achievement of fiscal targets combined with significant structural reforms facilitated Ireland's exit from the EU/IMF support programme in late 2013. Although strong growth has been recorded since, considerable risks remain due to the severity of the crisis. Ireland's openness to exogenous shocks and continuing high levels of public and private debt pose real risks to the public finances and economic progress. Full fiscal sustainability has yet to be achieved, with borrowings still necessary to fund public services. Adherence to the EU Stability and Growth Pact and the fiscal rules designed to limit the scope for pro-cyclical government expenditure increases represent the best means of limiting risks to our economic recovery. Within these fiscal rules the Government has been able to balance the competing demands of society as a whole: for example by meeting the needs for enhanced public services through recruitment of staff in Health and Education sectors which itself adds to the cost of the pay bill. These

measures, and the commencement of the unwinding of the Financial Emergency Measures in the Public Interest Acts, have been agreed and provided for within Budget 2016 allocations

40. The fiscal targets in Budget 2016 are based on the reduced remuneration rates as well as on the revenue accruing from the PRD and PSPR as currently provided for under the Acts here reviewed. The Government is committed to meeting the targets set out in Budget 2016.

41. The Financial Emergency Measures in the Public Interest Act 2015 which implements the terms of the Lansdowne Road Agreement constitutes a prudential and agreed approach to the phased unwinding of the measures in the relevant acts. Of major benefit is the certainty the Lansdowne Road Agreement provides for economic planning in the context of medium term expenditure ceilings and the operation of the fiscal rules.

42. Having considered the matter in line with section 12 of the 2013 Act, I am satisfied, having regard to the purposes of the relevant Acts, the overall economic conditions in the State, national competitiveness and Exchequer commitments in respect of public service pay and pensions that the measures put in place by the Acts here reviewed continue to be needed in 2016.

43. I also find that it is appropriate, taking account of the improvements brought about in the public finances, the continuing risks which remain and the need to meet our commitments to have a prudent fiscal policy under the Stability and Growth Pact, and subject to the amendments effected in the measures through the Financial Emergency Measures in the Public Interest Act 2015:

    a. to continue to apply the public service Pension-Related Deduction;
    b. to continue to apply the relevant provisions controlling the cost of remuneration of public servants, and other measures controlling the cost of the public service pay and pensions bill;
    c. to continue to apply the Public Service Pension Reduction; and
    d. to maintain provisions in the legislation which provide for the reduction of payments to health professionals but allow, subject to the considerations of the Minister for Health and other Ministers of Government under sections 9 and 10 of the Financial Emergency Measures in the Public Interest Act 2009 and

Government's priorities for the health service, for a gradual amelioration of the impact of payment reductions.

Paschal Donohoe

Paschal Donohoe, T.D.

Minister for Public Expenditure and Reform

29 June 2016