TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

Dept. of Taoiseach
DOT: Core Book 58

January 2016

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LINE OF INQUIRY: R4c

Analysis and consideration of the response to contrarian views (internal and external)

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National fiscal rules and institutions

In the discussions on the 2005 reform of the SGP, the Council emphasised the importance of strengthening fiscal governance in the Member States. It advocated that national budgetary rules should be complementary to the Member States' commitments under the SGP. The Council also underlined that domestic governance arrangements should complement the EU framework, and that national institutions could play a more prominent role in budgetary surveillance. A discussion on this topic is planned for later in the year.

The Commission paper suggests that institutional settings at national level can play an important role in containing spending and deficit biases. These settings include in particular (i) the procedural rules of the budgetary processes (ii) the numerical fiscal rules which guide or impose restraints on policy makers and (iii) the independent bodies or institutions which provide forecasts, analysis and recommendations in the area of fiscal policy.

The Commission undertook a survey of the fiscal rules and institutions in the EU 25 in the period 1990-2005. While most of the rules applied to regional and local governments are statutorily based, rules applying to the whole of the general government sector tend to be based on political agreements and commitments. The survey concluded that numerical expenditure rules lead to lower deficits. Strong fiscal rules with automatic enforcement mechanisms seem to have a larger influence on budgetary outcomes.

The Commission's survey found no significant evidence of the development of "fiscal councils" in the member states. It distinguished existing institutions which (i) provide forecasts and analysis of fiscal policy issues and (ii) institutes issuing statements and recommendations on fiscal policy. The survey concluded that delegation of the forecasting activity could address biases in macroeconomic projections. The existing institutions appear to influence public debate and policy formation. There also seems to be a perception that independent fiscal institutions have contributed to fiscal discipline.

Fiscal policy in good times

The Commission's analysis is that pro-cyclical fiscal policies have been frequent in euro-area countries in the past decades. Since the completion of EMU, budgetary correction in bad times has become less common, but there is a greater incidence of pro-cyclicality in good times and it is mainly related to expenditure. The survey acknowledges that technical issues such as the calculation of the output gap and measurement of the economic cycle are possible mitigating factors. The Commission conclude that a possible response to the pro-cyclical issue is setting up national-level rules and institutions "that permit governments to credibly commit not to surrender to the pressures to increase spending or cut taxes in good times."

The Commission consider that independent "fiscal councils" which produce macroeconomic forecasts and budgetary impact assessments could assist in the operation of medium-term expenditure and revenue rules (with particular reference to

the use of revenue windfalls or the establishment of rainy-day funds). This would support the objective under the reformed SGP of better fiscal consolidation in good times.

Comments on Analytical Sections

Ireland would be in a relatively strong position in terms of the institutional framework for fiscal policy. Budgetary policy is formulated in accordance with the SGP and a commitment to sustainable public finances. The arrangements for the control and monitoring of expenditure have been consistently updated in the context of public service modernisation. "Fiscal rules" include for example a medium-term expenditure framework and multi-annual capital budgets. Additional revenues are generally applied to improve the government balance. In relation to the fiscal council aspect, the ESRI like its European counterparts has a significant role in providing independent analysis on fiscal policy.

The findings of the Commission's survey are not surprising. As it states, ultimately all fiscal policy has a redistributive aspect and nowhere has fiscal policy been delegated.

ON THE LIKELY EXTENT OF FALLS IN IRISH HOUSE PRICES

Morgan Kelly[*]

Abstract

Looking at house price cycles across the OECD since 1970, we find a strong relationship between the size of the initial rise in price and its subsequent fall. Were this relationship to hold for Ireland, it would predict falls of real house prices of 40 to 60 per cent over a period of 8 to 9 years. The unusually large size of the Irish house building industry suggest that any significant house price fall that does occur could impose a difficult adjustment on the economy.

1. Introduction

The purpose of this paper is to look at the likely behaviour of Irish house prices based on the experience of economies that have gone through similar booms. Looking at nearly 40 booms and busts in OECD economies since 1970, we find that the size of the initial boom is a strong predictor of the size and duration of the subsequent bust.

Typically, real house prices give up 70 per cent of what they gained in a boom during the bust that follows. This is a remarkably robust relationship, holding across very different OECD housing markets over more than 30 years.

Were this relationship to hold for Ireland, it would predict a fall in real house prices of around 40 to 60 per cent, over a period of 8 or 9 years. Assuming an inflation rate of 2 per cent, this would translate into an annual fall of average selling prices of 6 to 7 per cent.

Falls of this magnitude and duration are not unprecedented internationally. For example, the real price of Dutch houses fell by around half during the 1980s, as did those in Finland during the early 1990s. However, other large housing busts occurred in

[*]I would like to thank Christophe Andre for providing the OECD house price database used here, and to a referee for detailed and constructive criticisms of the submitted draft. All interpretations and errors are mine.
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PUB01B11-P
Quarterly Economic Commentary, Summer 2007, pp. 42-54.

PUB00258-002

economies with high rates of housing occupancy and relatively slowly growing stocks of houses. In Ireland, by contrast, housing stock has been growing at around 5 per cent per year, with about 15 per cent of the housing stock lying empty, increasing the potential for larger price falls than in previous OECD housing busts.

Our estimate is in contrast with existing studies that measure over-valuation by the size of a regression residual and find over-valuation of around 20 per cent. We demonstrate below, however, that unless based on very long run time series, such regressions are effectively meaningless.

The principal macroeconomic reason for being concerned about a fall in Irish house prices is its impact on residential investment. Typically, an industrialised economy gets around 5 per cent of its income from building new houses, around the same that it gets from household spending on recreation. Ireland currently derives nearly three times this amount from building and selling houses. Any sudden fall of residential investment to normal international, and national historical, levels, could have a substantial impact on national income, government finances, and unemployment: fewer than 15 per cent of construction workers are immigrants.

Falls in residential investment, moreover, can be sudden as the example of Arizona shows. Until late 2005, Arizona was experiencing a house price and construction boom similar to Ireland's. Then, as sales of new houses stalled around the start of 2006, building fell suddenly: from around 8,000 starts in May 2006 (similar to Irish levels last year) to around 3,000 in November.

The stagnation of the housing market even below the stamp duty threshold makes it evident that the reduction or elimination of stamp duty will not alter the basic dynamics of the housing market. Markets like housing are driven by fear of offering less than other bidders and ending up with nothing. With a large inventory of unsold houses, the *permanent-tsb* house price index showing monthly falls, and the irishpropertywatch.com tracking site showing that cuts in asking prices of €50,000 are now commonplace, potential buyers have an incentive to wait and see if prices will fall further. At the same time, rents are likely to fall as discouraged vendors attempt to let out empty properties.

The rest of this paper is as follows. Section 2 rehearses the relevant economic theory of rational frenzies in asset markets. Section 3 looks at the nearly 40 cases since 1970 where OECD economies have experienced house price rises followed by falls, and shows that the magnitude of the boom is a strong predictor of the size and duration of the subsequent bust. Section 4 shows how the stagnation of rents since 2000 while house prices doubled means that the Irish housing market has not been driven by strong fundamental demand. Section 5 looks at the possible magnitude and duration of house price falls, and their potential macroeconomic effects.

2. Economic Theory

The familiar efficient markets hypothesis predicts that changes in asset prices are unpredictable. The price reflects individuals' information about asset's present value and changes as this information changes. Agents with good information buy, driving up the price, and those with bad information sell, driving it down.

However, instantaneous revelation of information through trade is not possible in house markets due to the very large transaction costs involved. In addition, the market lacks means for individuals to convey negative information through short sales.

As a result, housing markets are better modelled as information cascades: the actions of other agents signal their private information and can cause individuals to ignore their own signals and follow the herd (Bikchandani, Hirshleifer and Welch, 1992). Two models in the cascade literature are particularly useful for understanding the dynamics of housing markets: the rational frenzies model of Bulow and Klemperer (1994) and the wisdom after the fact model of Caplin and Leahy (1994).

Bulow and Klemperer (1994) model rational frenzies in auctions where participants reveal their valuations by bidding. Suppose that there are k items available. If individual reservation prices were known with certainty, everyone would wait until the price fell to just above the reservation price of the $k + 1$-th highest person, and then all buy together. In practice, only the probability distribution of reservation values is known, and by bidding, or failing to bid, individuals reveal information about their valuations, allowing all participants to update their estimates about the value of the $k + 1$-th highest reservation price.

As a result, bidders with very different valuations have very similar willingness to pay. Price drops until one person bids. The information this reveals about the true distribution of willingness to pay can set off a bidding frenzy among the other bidders, driving up price again until it becomes clear that price is again above willingness to pay. Bidding then stops, causing prices to collapse until another bidding frenzy starts.

As well as being volatile, Bulow-Klemperer predict that the relationship of house prices to fundamentals such as income and interest rates need not be straightforward. To the extent that individuals depart from Bayesian rationality, altering reservation values in response to observed trends in prices, these effects will be amplified.

Caplin and Leahy (1994) look at investment where individuals have Gaussian signals. If the true state is bad, individuals continue to invest, driven by the dominating effect of past actions. Eventually, however, because signals are not bounded, a few agents get sufficiently bad signals to induce them to stop investing, causing priors rapidly to move to a belief that the state is bad, leading to a market crash and "wisdom after the fact".

3. Mean Reversion in House Prices

Economic theory predicts that house prices should not follow a random walk, but should be a mean-reverting process of booms and crashes around a slowly increasing trend reflecting the growth of household income. This is what the international data show.

Large falls in real house prices in the aftermath of housing booms are common internationally. Table 1 shows the 18 cases since 1970 where OECD economies have experienced falls in real house prices of at least 20 per cent, along with the previous price rise, and the duration of the fall. It can be seen that, in contrast to stock or currency markets, falls are prolonged, usually lasting 5 to 7 years, with the Netherlands, Switzerland, and Japan all experiencing more than a decade of falls. This reflects the reluctance of sellers to cut nominal prices, meaning that inflation does most of the work in reducing real prices.[1]

Table 1: Magnitude and Duration of Falls in Real House Prices

	Peak Year	% Fall	Previous Rise	Duration of Fall
Netherlands	1978	50	98	7
Finland	1989	-48	109	6
Switzerland	1989	-39	70	10
Norway	1987	-39	53	6
Denmark	1978	-36	22	4
New Zealand	1975	-35	57	5
Sweden	1979	-35	26	6
Spain	1977	-33	24	4
Denmark	1986	-32	52	6
Japan	1974	-31	56	4
Italy	1982	-30	84	4
Finland	1974	-30	22	5
Japan	1991	-27	78	10
Sweden	1990	-27	38	6
Italy	1992	-26	65	6
Switzerland	1973	-26	34	4
Ireland	1981	-22	53	5
Canada	1981	-20	6	4

Shiller (2006) looks at three long series of real house prices: Amsterdam from 1628 to 1973, Norway from 1819 to 1989, and the United States from 1890 to 2005. In all cases he finds that although there are substantial and long lasting peaks and troughs, there is scarcely any upward long-run trend in prices.

Figure 1 shows the same pattern for smaller OECD economies: the Nordic countries, the Netherlands, and New Zealand, since 1970. The diagram shows the ratio of average house prices to disposable income but real house prices show a very similar pattern. Again, as economic theory predicts, there is considerable volatility and no sign of long-run trends. In contrast to stock price data, the tendency of prices to return to their long-run average means that

[1]The referee observes the one small economy that is notably absent from the list of booms and busts is Belgium. It would be useful to identify the sources of this stability, and whether they could be adapted to reduce future volatility in the Irish market.

the size of price falls can be predicted from the size of the price rise that preceded them.

Figure 1: House Prices Relative to Disposable Income in Smaller OECD Economies Since 1970. Index: 2000 equals 100

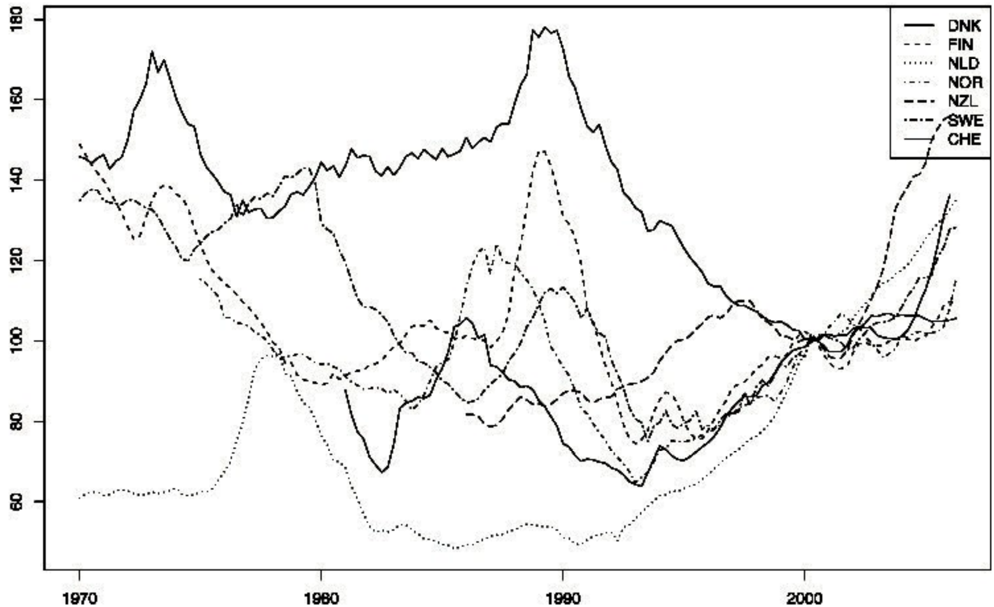


Figure 2 plots the size of increase in house prices for 17 OECD economies, against its subsequent fall.[2] For clarity, we exclude other variables such as interest rates that other studies find to have limited explanatory power for house prices: we are focusing on weak form efficiency of housing markets.

To estimate the peaks and troughs in each series for each country, we first calculated percentage changes for each quarter. A Friedman supersmoother (implemented in the R statistics package) was then applied to the percentage changes to eliminate short-run fluctuations. Peaks and troughs were then identified as the end of runs of positive or negative changes in the smoothed series, and actual price changes calculated between these points.

Percentage rises and subsequent falls are calculated relative to different values: troughs and peaks respectively. Remember that a rise of p per cent only needs a fall of $p/(1 + p)$ per cent to reverse it. To eliminate this complication, all rises in Figure 2 and subsequent regressions are expressed as a percentage of peak values: for example a rise from 50 to 100 is treated as a 50 per cent rise, rather than a 100 per cent one.

[2]These economies are Denmark; Finland; Ireland; Netherlands; Norway; New Zealand; Sweden; Switzerland; United States; Japan; Germany; France; Italy; Britain; Canada; Australia and Spain.

Figure 2 shows that there is a strong linkage between rises in real house prices and subsequent falls. There is one evident outlier corresponding to a dip in house prices in Spain that occurred in the early 1990s in an otherwise continuously up-ward trend that saw real prices quadruple between the mid-1980s and the present.

Figure 2: Percentage Rises in Real House Prices (Expressed as a Percentage of Peak Values), and Subsequent Falls for OECD Economies Since 1970

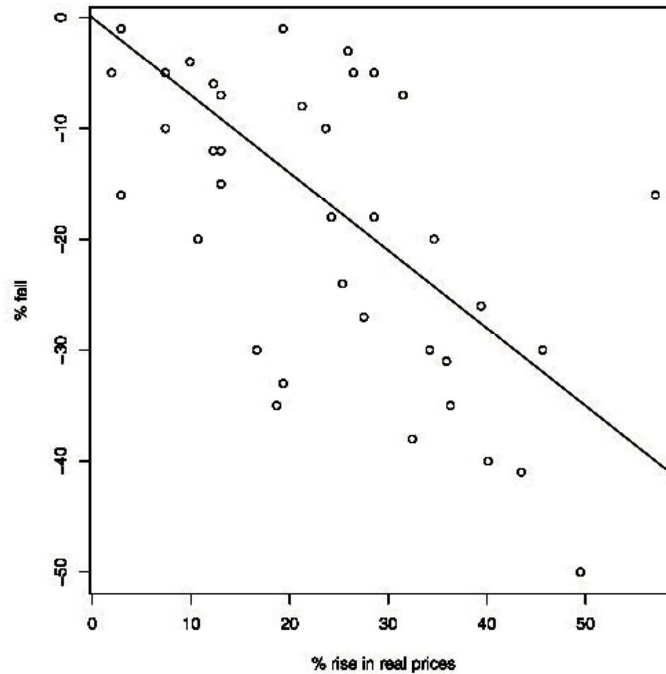


Table 2 shows a regression of the percentage fall in house prices against their previous rise, both including and excluding the Spanish early-1990s outlier, for real house prices and the house price to income ratio. The slope of -0.7 for real house price means that 70 per cent of the rise during a boom (expressed relative to the peak value) is lost during the subsequent bust.

It is worth emphasising that these regressions are simply a summary of data. Beyond being a standard test of weak form efficiency of the housing market, they do not purport to test any model. In particular, the approach here can convey no information about the timing and magnitude of peaks preceding troughs.

By comparison Glaeser and Gyourko (2006) find weaker mean-reversion in house prices in US metropolitan areas: a one dollar rise over five years is typically followed by a fall of 30 cents over the following five years.

Table 2: Predictability of House Price Falls from Preceding House Price Rises

	Intercept	Initial Rise	SER	R_2	BP	N
			Real House Prices			
All	-0.0489 (0.0363)	-0.5746** (0.131)	0.1085	0.3548	0.022	37
Excl. Spain	-0.0252 (0.0356)	-0.7025** (0.1347)	0.1021	0.4445	0.483	36
			House Prices Relative to Disposable Income			
All	-0.1168** (0.0389)	-0.6115** (0.1899)	0.1275	0.219	0.187	39
Excl. Spain	-0.104** (0.0395)	-0.713** (0.2013)	0.1259	0.2584	0.428	38

OLS regression of percentage falls in real house prices and house prices relative to income on preceding rises for 17 OECD economies from 1970 to the present. Standard errors in parentheses. *denotes significance at 5 per cent, ** at 1 per cent. BP is p-value of studentised Breusch-Pagan test for heteroskedasticity.

What is notable about the diagram and regressions is how strong the relationship between price rises and falls is. Across very different housing markets in very different economies over a period of more than 30 years, there is a common relationship between the magnitude of booms and subsequent busts. Rent-price series show similar mean reversion but because of the small size of the rented sector in many economies, and the presence of rent controls in part of the period, the data are not as reliable as the real price and price-income series.

As always, national averages conceal substantial variations across regions and types of property. During the last British housing crash, for example, while selling prices nationally fell on average by 10 per cent, they fell in East Anglia by 40 per cent; while models such as Glaeser and Gyourko (2006) predict that the upper end of the market should be the most volatile.

As Table 1 suggests, there is a relationship between the magnitude of real price falls and their duration. Table 3 gives the results of a regression of the average annual rate of house price falls on their magnitude, and shows the two to be closely related. If p is the proportionate price fall, so prices fall from 1 to $1 - p$ over t years, it follows that $r = \ln(1 - p)/t$ is the average rate of decline. Table 3 gives the results of a regression of r on p. For every 10 per cent extra decline in real prices, the annual rate of decline rises by 1.5 percentage points.

Figure 3: Rate Versus Magnitude of Falls in Real House Prices for 17 OECD Economies Since 1970

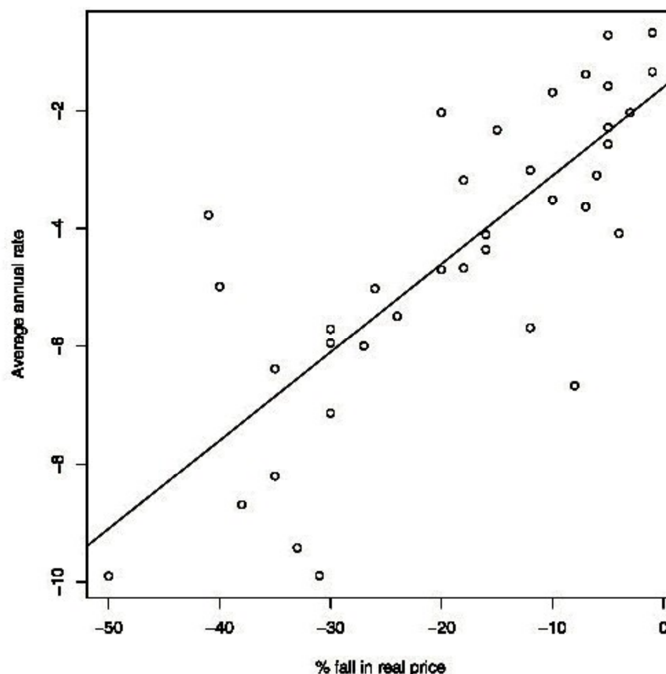


Table 3: Connection Between Annual Rate of Decline and Magnitude of House Price Falls

Intercept	Price Fall	SER	R_2	BP	N
-1.6784** (0.4709)	0.1494** (0.0206)	1.6434	0.6014	0.121	37

OLS regression of average rate of fall of real house prices on percentage fall for 17 OECD economies from 1970 to the present. Standard errors in parentheses. *denotes significance at 5 per cent, ** at 1 per cent. BP is p-value of studentised Breusch-Pagan test for heteroskedasticity.

4. The Irish Housing Bubble, Causes and Consequences

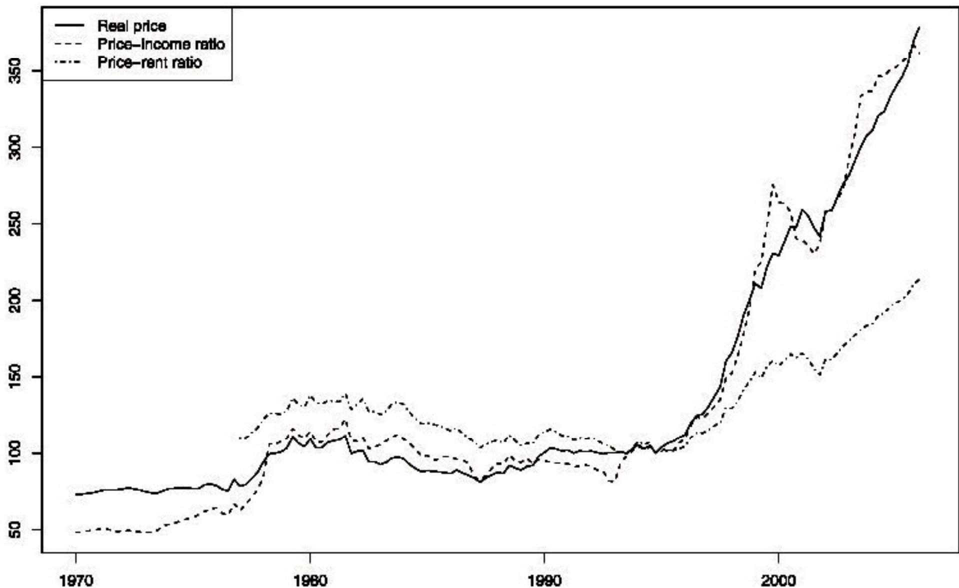
The evidence of nearly 40 cycles in house prices for 17 OECD economies since 1970 shows that real house prices typically give up about 70 per cent of their rise in the subsequent fall, and that these falls occur slowly.

Before looking at what these numbers may imply for Ireland, it is necessary to dispose of the idea that Irish house prices merely reflect strong fundamentals: rising income and increased household formation due to the age structure of the population, declining household size, rising employment, and immigration.

This argument is hard to sustain. If the rise in house prices were due to increased income and more people needing somewhere to live, we would have observed rents rising alongside house prices. Figure 4 shows how house prices have risen far faster than either

rents or income. In fact, while rents doubled relative to income between 1995 and 2000, the ratio has remained unchanged since. The failure of rents to rise, along with the number of recently built units that have been bought but are lying empty (FitzGerald, 2005), suggests that the Irish housing market has left the dull world of fundamental values far behind it.

Figure 4: Irish House Prices Since 1970 in Real Terms, Relative to Income, and Relative to Rent. Index: 1995 Equals 100



A back of envelope calculation of the fundamental price of housing is the following. Abstracting from maintenance costs (which typically run around one month's rent) suppose that housing generates an annual rent of n. This is a fraction ν of disposable income y which is expected to grow through time at rate g. The present value of this infinite income stream is then

$$p = \frac{\nu y}{r - g}$$

where r is the discount rate. As Figures 1 and 2 and Table 1 show, housing is not a risk-free asset, and this discount rate needs to exceed the risk-free rate by an amount reflecting the fundamental risk of the asset. For housing, fundamental risk is large: housing is the largest item by far in most people's asset portfolio and price changes are strongly correlated with income growth. To be conservative, however, we can assign a value of r of 8 per cent, equal to the long run real return on equities.

The ratio of fundamental price to rent is $1/(r - g)$. To explain why Irish house prices have doubled relative to rent since 2000 we need to ask if there is any reason to suppose that new information has arrived causing long run estimates of $(r - g)$ to be rationally halved.

Ireland's stagnant exports, diminishing competitiveness, and the increasing structural problems of sectors such as IT and pharmaceuticals, would suggest that estimates of long-run income growth for the Irish economy g should have fallen in this period. While it may be the case that increased international demand for quality assets may be driving down equilibrium returns (Caballero, 2006), there is no reason to believe that long-run expected returns on risky assets r have halved in the past 7 years.

As White (2006) has observed, there is considerable variation in price-rent ratios within Dublin, with values in the range 80-100 at the top of the market. These values recall the peaks of the dotcom bubble and can be rationalised, with a discount rate $r \approx 0.08$, only with real long-run growth of income of 6 to 7 per cent, equivalent to a doubling of real income every 10-12 years. This is the rate achieved by Korea during its transition from effectively the stone age to an industrial economy but has not been remotely approached by any rich economy. Alternatively, assuming an equilibrium price-rent ratio in the region of 15, it suggests that large falls in prices, of the order of 85 per cent, might be needed for the top of the market to return to fundamental value.

Again it is worth reminding ourselves that, just as in stock markets, fundamental measures such as price-earnings ratios have limited explanatory power for price changes in the short run.

While other parts of the market appear less over-valued, they are still expensive by international standards. The Global Property Guide website reports that the average Dublin apartment rents for around 4 per cent of its purchase price. Only Madrid among major cities has a lower ratio. By comparison, London apartments return nearly 6 per cent, and Amsterdam and Paris over 8 per cent.

5. International Perspectives on the Irish Housing Bubble

Were Ireland to experience the same housing dynamics as every other OECD economy, except Spain in the early 1990s, what sort of price changes might be expected? Recall that Table 2 predicts a 7 per cent fall for every 10 per cent rise (relative to peak values) of real prices from their trough level, with a standard error of 10 per cent.

Since the mid-1990s, real house prices have risen from an index level of 100 to around 350, and increase in terms of peak value of 70 per cent. If 70 per cent of this rise were to be subsequently lost – as occurred during our previous bust in the early 1980s – the predicted fall in real house prices would be 50 per cent with a standard error of 10 per cent. In other words, a 68 per cent confidence interval for price falls would be in the range of 40 to 60 per cent. There would be one chance in eight of a price fall of only 30 to 40 per cent, just as there is a predicted one chance in eight of a fall of 60 to 70 per cent.

Similarly, Table 2 predicts, given an approximately 70 per cent rise in the price income ratio, that the price income ratio will fall by around 60 per cent, with a standard error of around 12.5 per cent.

It must be emphasised that these estimates are extrapolations: no economy in our sample of busts following booms experienced a rise as large as Ireland's. A fall in real prices of 50 per cent from Table 3, implies a predicted annual rate of decline of around 9 per cent, with a standard error of approximately 1.5 per cent. This translates into a decline of around 8 years, of the same order of magnitude as that experienced in the Netherlands in the 1980s or Britain in the 1950s. Assuming an inflation rate of 2 per cent, this implies an annual fall in selling prices of 7 per cent.

These estimates may be unduly optimistic. In all the housing cycles on which the regression was based, housing stock was, for practical purposes, fixed. In Ireland, by contrast, the number of housing units is growing at around 5 per cent per year, which would suggest the potential for larger falls than those experienced in other OECD housing slowdowns.

5.1 FUNDAMENTAL REGRESSIONS

The prediction that Ireland may experience house price falls in the range of 50 per cent, is a good way from the OECD estimate (Rae and van den Noord, 2006) that Irish houses are overvalued by only around 20 per cent. However, the OECD methodology, and that of similar studies, is problematic. Such studies run a regression of house prices on interest rates, disposable income, employment and other fundamental variables. The regression residuals are then equated with the degree of over- or under-valuation in the market.

To see this, consider a regression of Irish real house prices on disposable in-come since 1976 gives a residual for the last quarter of 2006 of 17 per cent. If instead house prices had changed by twice as much each quarter as they did, the regression residual would find that they were 35 per cent over-valued, while prices would be four times as high as they are now. Measuring over-valuation using regression residuals is a valid approach if very long-run series are available to tie down coefficient values, but using short-run series, as existing studies do, leads to meaningless results.

5.2 MACROECONOMIC CONSEQUENCES

House price falls have three effects. First, households feel less wealthy and consume less. Evidence from the United States points to a final long-run marginal propensity to consume from housing wealth of around 10 per cent: a $100,000 rise in property values, increases household consumption eventually by a total of $10,000 (Carroll, Otsuka and Slacalek, 2006). Second, banks face more bad loans, and become more cautious in their lending, leading to further falls in creditworthiness through the standard financial accelerator. Finally, the value of Tobin's q for residential investment falls, reducing house building. Most countries devote about 5 per cent of national income to building houses and in a typical housing bust, this falls to around 4 per cent of national income.

In most cases then, housing busts are uncomfortable, but not macroeconomically disastrous events. How about Ireland? There is some evidence that the wealth effect on consumption might not

be as strong as in the United States: there has been no fall in personal saving in Ireland during the housing bubble, and households have not consumed home equity through second mortgages (Hogan and O'Sullivan, 2006). Similarly, the larger banks which dominate lending are well capitalised and the banking system has, until recently at least, avoided the worst excesses of the sub-prime mortgage market, although it is likely that many interest-only and 100 per cent mortgages could go sour, especially given the ease with which delinquent borrowers can relocate to England.

It is the scale of the Irish house building industry that makes a fall in house prices potentially troubling. While most economies derive only 5 per cent of their income directly from residential construction, in Ireland house building accounts for around 15 per cent of national income.

Effectively, the recent growth of the Irish economy looks similar to the unstable case of an old-fashioned multiplier-accelerator model. The employment growth in the Celtic Tiger period of the 1990s led to increased demand for housing, reflected in rising real house prices and rent to income ratios. This stimulated house building, which generated more employment, leading to more demand for housing, and so on. Effectively, the Irish economy has come to be driven by building houses for all the people whose jobs have come, directly or indirectly, from building houses.

It is hard to envisage how a fall in house building from 15 per cent to 5 per cent of national income might be achieved without considerable macroeconomic dislocation. Building booms, moreover, tend to end suddenly: the example of Arizona in the summer of 2006 shows how a housing market can move in the space of a few months from buyers queuing overnight to buy, to empty tracts of new houses being priced below construction cost and still failing to sell.

6. Conclusions

This paper has taken an international perspective on the Irish housing boom. We have shown that there is a close relationship historically across very different economies and housing markets between the size of increases in real house prices, and subsequent declines. If this relationship were to hold for Ireland, the expected fall in average real house prices is in the range 40 to 60 per cent, over a period of around 8 years. Such a fall would return the ratio of house prices to rents to its level at the start of the decade. Given the unusual reliance of the Irish economy on building houses, the effects of any such fall on national income may be somewhat larger than that experienced at the end of other housing bubbles.

Policy implications are straightforward. Booms and busts are a normal part of property markets. The government did not cause the current boom, and is powerless to do anything about a subsequent bust. In particular, cuts in stamp duty will not change buyers' self-fulfilling incentive to wait and see if prices fall further.

Blanchard (2006) has observed that Euro-area economies appear at risk of rotating recessions: increased domestic demand drives up real wages and erodes competitiveness, but the impossibility of

devaluing means that prolonged rises in unemployment become the only means to reduce real wages. Notable current examples are Italy and Portugal. There may be some risk that the sharp fall in Irish competitiveness since 2000, which has been disguised and, to some extent, caused by the construction boom, may require a lengthy period of high unemployment to reverse.

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Executive summary

Ireland has continued its exemplary economic performance, attaining some of the highest growth rates in the OECD. After a remarkable decade, per capita income has caught up with and overtaken the EU average. Further progress will require strong productivity growth and continued increases in labour supply. These challenges are familiar to most OECD economies. But it also faces some issues that are less common: it is going through a transition phase in upgrading its social services; infrastructure levels need to catch up with the boom in activity and population that has occurred over this period; and it has to manage some sizeable macroeconomic risks.

Maintaining high rates of productivity growth. *As Irish activity comes to rely less on foreign firms and more on home-grown services, productivity gains will become harder to achieve. The main areas where policy could make a difference in sustaining productivity growth are:*

- *Boost competition. There are too many sectors where producers are shielded from competition, raising prices and stifling growth. Reforms are needed in the electricity and telecom sectors, and unnecessary restraints in services such as law, pharmacies and the pub trade should be removed. In the retail sector, the government's decision to abolish the Groceries Order is welcome.*
- *Improve education. Funding is still an issue in universities. One option is to re-introduce tuition fees, but backed by an income-contingent loan scheme. In secondary schools, the key challenge is to target resources on students who are struggling.*
- *Encourage innovation. The science framework needs to improve before public spending is increased further. The many funding agencies could be amalgamated or better co-ordinated; public support could shift towards market-driven measures; and resources should not be spread too thinly.*
- *Upgrade infrastructure. Rigorous cost-benefit analysis of infrastructure projects, including those in the ten-year transport plan, should play a greater role in decision-making than has been the case in the past. Moreover, an increasing number of projects should be financed by users.*

Boosting labour supply. *An important option for boosting labour supply is to raise female participation. Expanding day-care for infants and out-of-school care for children will help. From the point of view of labour market participation, childcare supports such as the new Early Childcare Supplement should be linked to employment status or made conditional on actually using formal childcare. A mutual-obligations approach for sole parents would help reduce child poverty by assisting parents to get a foothold in the labour market. As regards older people, work incentives in the public-pension and welfare systems could be improved. Migrants will also continue to play an important role in alleviating labour supply bottlenecks. The attractiveness of Ireland for immigrants will be influenced by the overall price level (including house prices) and the quality of public services.*

Macroeconomic risks are high. *As one of the OECD's more open economies, Ireland is particularly exposed to external risks. But it also faces domestic risks. House prices may have overshot fundamentals to some extent, although this does not imply that they will fall significantly; and house building will eventually ease. A soft landing is the most likely scenario but a sharper fall cannot be ruled out. Hence, the government needs to leave plenty of breathing space by balancing the budget or running a surplus, curtailing tax breaks and pushing ahead with public management reforms to get better value for money from public expenditure.*

OECD ECONOMIC SURVEYS: IRELAND – ISBN 92-64-02219-8 – © OECD 2006

THEME: R5

Clarity and effectiveness of the Government and Oireachtas oversight and role

LINE OF INQUIRY: R5a

Effectiveness of the Oireachtas in scrutinising public policy on the banking sector and the economy

EUROPEAN CENTRAL BANK

EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Mr Brian Cowen
Taoiseach
and Prime Minister
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010
L/JCT/10/1438

Dear Prime Minister,

Please find attached a copy of the letter I sent today to Mr Lenihan.

With kind regards

Encl. Letter to Minister Lenihan dated 19 November 2010

Kaiserstrasse 29, 60311 Frankfurt am Main, Germany · Tel.: +49 69 13 44 73 00 · Fax: +49 69 13 44 73 05

EUROPEAN CENTRAL BANK

EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Mr Brian Lenihan
Tánaiste and
Minister of Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010
L/JCT/10/1444

Dear Minister,

As you are aware from my previous letter dated 15 October, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other national central bank of the Eurosystem, is closely monitored by the Governing Council of the European Central Bank (ECB) as it may interfere with the objectives and tasks of the Eurosystem and may contravene the prohibition of monetary financing. Therefore, whenever ELA is provided in significant amounts, the Governing Council needs to assess whether it is appropriate to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the prohibition of monetary financing, it is essential to ensure that ELA recipient institutions continue to be solvent.

As I indicated at the recent Eurogroup meeting, the exposure of the Eurosystem and of the Central Bank of Ireland vis-à-vis Irish financial institutions has risen significantly over the past few months to levels that we consider with great concern. Recent developments can only add to these concerns. As Patrick Honohan knows, the Governing Council has been asked yesterday to authorise new liquidity assistance which it did.

But all these considerations have implications for the assessment of the solvency of the institutions which are currently receiving ELA. It is the position of the Governing Council that it is only if we receive in writing a commitment from the Irish Government vis-à-vis the Eurosystem on the four following points that we can authorise further provisions of ELA to Irish financial institutions:

1) The Irish government shall send a request for financial support to the Eurogroup;

2) The request shall include the commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;

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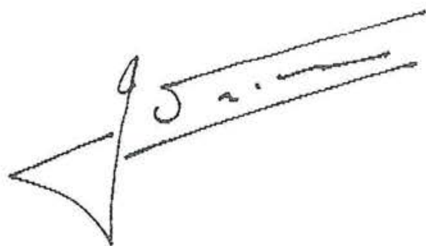
3) The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish government as well as by financial means currently available to the Irish government, including existing cash reserves of the Irish government;

4) The repayment of the funds provided in the form of ELA shall be fully guaranteed by the Irish Government, which would ensure the payment of immediate compensation to the Central Bank of Ireland in the event of missed payments on the side of the recipient institutions.

I am sure that you are aware that a swift response is needed before markets open next week, as evidenced by recent market tensions which may further escalate, possibly in a disruptive way, if no concrete action is taken by the Irish government on the points I mention above.

Besides the issue of the provision of ELA, the Governing Council of the ECB is extremely concerned about the very large overall credit exposure of the Eurosystem towards the Irish banking system. The Governing Council constantly monitors the credit granted to the banking system not only in Ireland but in all euro area countries, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks and the collateral they provide to the Eurosystem. The assessment of the Governing Council on the appropriateness of the Eurosystem's exposure to Irish banks will essentially depend on rapid and decisive progress in the formulation of a concrete action plan in the areas which have been mentioned in this letter and in its subsequent implementation.

With kind regards



Cc.: Mr Brian Cowen, Prime Minister

Statement by An Taoiseach, Mr Brian Cowen TD on Provision of International Financial Support for Ireland

Dublin, 28 November 2010

I can confirm that the Government has concluded negotiations with our European partners and international institutions, including the European Commission, the European Central Bank and the International Monetary Fund.

We have reached agreement on a programme for the provision of significant international financial support for Ireland.

A programme of assistance for Ireland totalling 85 billion euro has been agreed.

This includes external assistance of 67.5 billion euro, comprising 45 billion euro from the EU and bilateral loans from the UK, Sweden and Denmark and 22.5 billion euro from the IMF.

The estimated average interest rate on the loans is in the order of 5.83% per annum, based on current market conditions.

The duration of the programme is 3 years, while the average length of loan is up to 7.5 years.

The remaining 17.5 billion euro in the programme will be funded from Ireland's own resources – 5 billion from our cash reserves and 12.5 billion from the pension reserve fund.

This approach is reasonable in the context of such large loans from other countries and as a means of reducing the total amount of debt involved.

Crucially for Irish jobs, the agreed programme does not involve any change to our Corporation Tax rate of 12.5%.

In addition, we have obtained more room for manoeuvre by agreeing with the European Commission that the timeframe for reducing the deficit below 3% of GDP can be extended to 2015, if the four-year adjustment of 15 billion euro proves insufficient.

This programme is absolutely essential for our country.

The Government's agreement to it follows very tough negotiations over recent days.

Those negotiations, and the agreed programme, have been informed by the most robust consideration of our national interest and the broader interests of the eurozone.

We have carefully considered all available policy options.

In reaching this agreement, the Government has accepted the recommendations of the Minister for Finance, the Governor of the

Central Bank and the Chief Executive of the National Treasury Management Agency.

While the agreement has important implications for the European Union as a whole, I wish to address my remarks this evening to the people of Ireland.

The first point that people should know is that the significant loans being provided to Ireland are necessary to allow us to fund our budgets over the coming years.

These loans will provide money that we had already planned to borrow on the international markets.

That funding will now be available to Ireland at a cheaper interest rate than if we borrowed on the markets.

Without these loans, the necessary tax increases and spending cuts would be far more severe, and they would be imposed far more quickly, than is proposed in the Government's National Recovery Plan.

A large portion of the loans – some 50 billion euro - will be used to fund the Exchequer.

This will be used to help to pay for social welfare payments, pensions, health, education and other public services over the coming years, as we manage the transition to a sustainable deficit and debt position.

The remaining portion of the facility being put in place will be devoted to support for the banking system.

This will be drawn down as required while the necessary reform and restructuring of the Irish banks is brought to a conclusion, and in a manner that facilitates the continued effective provision of credit to Irish businesses.

This support will also include the funds drawn from our own reserves.

10 billion euro will be drawn down immediately for the purposes of bank capitalisation, with the remaining 25 billion available on a contingency basis.

Compared to the National Recovery Plan projections, the programme involves an increase in the national debt.

The precise extent of that increase depends on how much additional funding for the banking system is drawn down, as well as on future economic growth.

The Government estimates that the debt ratio will stabilise in 2013 and that interest payments would represent over 20% of tax revenue in 2014.

It is worth recalling that in 1985 interest payment costs reached close to 35% of tax revenue

This represents a very large increase in our national debt over the course of this unprecedented economic crisis and this must be addressed over time.

Nevertheless, it is sustainable if we fully implement the National Recovery Plan.

The second important issue is that people understand that what has been agreed today is broadly consistent with policies already set out in the National Recovery Plan.

It endorses the proposed adjustment of 6 billion euro next year and 15 billion euro over the next four years.

It does, however, recognise that because of a more cautious outlook for economic growth and additional debt service costs, the timeframe for reducing the budget deficit to 3% of GDP should be extended to 2015.

While this does not alter the existing targeted adjustment of 15 billion euro up to 2014, it does mean that we have further room for manoeuvre if economic growth is lower than expected.

As with the National Recovery Plan, the agreed programme sets out the actions to be undertaken by Ireland to deliver on the structural reforms that are necessary to meet our budgetary targets and to promote economic growth and job creation.

Progress on all the actions set out in the programme will be reviewed on a quarterly basis, while the National Recovery Plan will be reviewed on an annual basis as already announced.

The next step in the implementation of the National Recovery Plan and the programme of international assistance is the passing of the Budget for 2011.

As you are aware, this will be presented to Dáil Eireann on December 7th.

The third important issue agreed today concerns the reform and restructuring of the Irish banking system.

The agreed programme sets out a detailed set of actions in that regard.

This will involve an intensification of the measures already adopted by the Government.

The programme provides for a fundamental downsizing and reorganisation of the banking sector

This will lead to a smaller banking system, more proportionate to the size of the economy, capitalised to the highest international standards, with renewed access to normal market sources of funding and focused on strongly supporting the recovery of the economy.

The Government Statement includes an information note that sets out the key measures within the Programme in relation to the bank restructuring and reorganisation.

In conclusion, I want to reiterate that this agreement is necessary for our country and our society.

It is in the best interests of Ireland and of the European economy on which our future prosperity depends.

In particular, I want to make it very clear that all of the options for reducing the cost to Ireland of the resolution of our banking difficulties – including the importance of requiring subordinated bondholders to share the burden of bank losses - were fully explored by the Government during the negotiations.

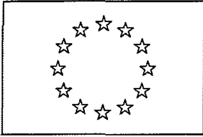
The proposed programme has been developed with the assistance of, and is endorsed by, our international partners.

The final agreed programme represents the best available deal for Ireland.

It allows us to move forward with secure funding for our essential public services, our welfare state and for the most vulnerable members of our society who depend on them.

It provides Ireland with vital time and space to successfully and conclusively address the unprecedented problems that we have been dealing with since this global economic crisis began.

ENDS



EUROPEAN COMMISSION

Brussels, xxx
SEC (2010) xxx

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN COMMISSION

AND

IRELAND

The present memorandum of understanding contains the following documents:

(a) A memorandum of economic and financial policies
(b) A memorandum on specific economic policy conditionality
(c) A technical memorandum of understanding

The memorandum of understanding may be amended upon mutual agreement of the parties in the form of an Addendum. The Addendum will be an integrated part of this Memorandum and will become effective upon signature.

Done in Brussels on ..../12/2010 ... and in Dublin on ..../12/2010 in three originals, in the English language.

For Ireland

For the Central Bank of Ireland

Brian Lenihan
Minister for Finance

Patrick Honohan
Governor of the ~~Irish~~ Central Bank of Ireland

For the European Commission

Olli Rehn
Member of the European Commission

Memorandum of Economic and Financial Policies

1. We have concluded that Ireland expeditiously requires a strong programme to restore domestic and external confidence and, thus, snap the pernicious feedback loops between the growth, fiscal, and financial crises.

2. We propose that such a programme comprise of four key elements:

- A fundamental downsizing and reorganisation of the banking sector—complemented by the availability of capital to underpin solvency—is required to restore confidence. Addressing market perceptions of weak bank capitalisation, overhauling the banks' funding structure, and immediately beginning a process of downsizing the banking system will be required.

- An ambitious fiscal consolidation building, on the progress already made.

- Renewing growth through a multi-pronged effort.

- A substantial external financial assistance will support the achievement of our policy objectives.

Recent Economic Developments and Outlook

3. After two years of sharp declines in output, the Irish economy is expected to broadly stabilise this year before expanding during 2011–14. As domestic imbalances from the boom years are being repaired, the recovery will, at least initially, be primarily export-driven. We project that GDP growth will increase over time as export performance filters through to investment and consumption, consumer confidence returns, and labour market conditions improve. We recognise that the risks in the short term are tilted to the downside, and, in particular, the headwinds from fiscal consolidation on domestic demand could be larger than anticipated. Over the longer haul also, continued private and public sector balance sheet adjustments, coupled with a weak banking sector, could delay the recovery.

4. Inflation is expected to remain low, reflecting the large output gap and modest external price pressures. Although the inflation rate will likely increase over time, it is expected to remain lower than in trading partner countries. This will have the benefit of improving competitiveness but the low rates of inflation would unavoidably keep real debt burdens high and dampen domestic demand.

5. The current account balance is projected to continue to improve gradually over the medium term, reflecting export expansion and the contraction in domestic demand. However, profit repatriation from multinationals and large interest payments to foreign holders of Irish debt are expected to limit the improvement over the programme period.

Restoring Financial Sector Viability

6. With its large size relative to the economy, its heavy reliance on wholesale funding, and its large exposures to the real estate sector, much of the domestic Irish banking system is in a stressed state. The Government has intervened heavily to safeguard financial stability. In late 2009, we established the National Asset Management Agency (NAMA) to take over certain vulnerable commercial and property development assets of banks. In addition, major efforts have been made to boost banks' capital.

7. Although the Government has made strong efforts to contain the fallout from the sector's vulnerabilities, a continued lack of market access and the loss of deposits have created significant funding pressures, alleviated largely by an increase in recourse to Eurosystem financing facilities and Emergency Liquidity Assistance by the Central Bank. Moreover, capital injections in the banks have placed a heavy burden on public finances.

8. Our proposed programme will take decisive steps to ensure the viability and health of the financial system. We intend to lay the foundations of this process very quickly, if we are to reassure the markets that banks will return to viability and will have the ability to operate without further state support in a reasonable period of time.

9. The key component of our efforts is an overhaul of the financial sector with the objective of substantial downsizing, isolating the non-viable parts of the system and returning the sector to healthy functionality. It will be important to support this process through capital injections into viable financial institutions. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability to the system. It is our goal that the leaner and more robust system that emerges from these efforts will not be dependent on state support, will have a more stable funding base, and will provide the credit required to foster growth.

10. The plan to overhaul the banking system has several elements. First, banks will be required to run down non-core assets. Second, land and development property loans that have not yet been transferred to NAMA will also be transferred. Third, banks will be required to promptly and fully provide for all non-performing assets as needed. Fourth, the banks will be required to securitise and/or sell asset portfolios or divisions with credit enhancement if needed, once the market normalises. And finally, swift and decisive action will be taken to resolve the position of Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS) in a way that protects depositors and strengthens the banking system. To this end, by end-January 2011, we will submit to the European Commission a revised proposal developed in collaboration with IMF, to resolve Anglo and INBS. Each of these initiatives will require technical or legislative measures, most of which we believe can be expeditiously instituted.

11. To achieve the above goals, banks will be required to submit deleveraging plans to the national authorities by end-February 2011. The plans will be prepared on the basis of clear periodic targets defined by the Central Bank, taking into consideration the Prudential Liquidity Assessment Review (PLAR) to be conducted in consultation with the EC, ECB and IMF. By end-March 2011, the Central Bank with assistance from an internationally recognised consulting firm, will complete the assessment of the banks' restructuring plans (structural benchmark). The deleveraging plans will be a component of the restructuring plans to be submitted to the European Commission for approval under EU competition rules.

12. This reorganisation and downsizing of the banks will be bolstered by raising capital standards. While we expect that, in a restructured system, banks will be able to raise capital in the market, we recognise that the higher standards may imply that, in the short run, public provision of capital will be needed for banks that are deemed to be viable. To support this process—and to render it credible—we will undertake a review of the capital needs of banks on the basis of a diagnostic of current asset valuations and stringent stress tests (PCAR 2011).

- As an immediate step, to enhance confidence in the solvency of the banking system, the Central Bank will direct Allied Irish Bank (AIB), Bank of Ireland (BoI) and EBS to achieve a capital ratio of 12 percent core tier 1 by end-February 2011 (structural benchmark) and Irish Life & Permanent (ILP) by end-May 2011 (structural benchmark). This would imply an injection of fresh equity capital of €7bn into these four banks and provide an additional buffer for a potential increase in expected losses. This action, along with early measures to support deleveraging and taking account of haircuts on the additional loans to be transferred to NAMA (see ¶10) would result in an injection of €10bn of fresh capital into the banking system, above and beyond the already committed capital injection of €6.6bn for AIB previously announced by the Irish authorities.

- By end-December 2010, in consultation with EC, ECB, and IMF staff, we will define the criteria to run stringent stress test scenarios (structural benchmark). We will also agree with EC, ECB, and IMF staff, by end-December 2010, on draft terms of reference for the due diligence of bank assets by internationally recognised consulting firms (structural benchmark). We intend to complete the diagnostic evaluation of banks' assets by end-March 2011 and the stress tests (PCAR 2011) by end-March 2011 (both structural benchmarks), and transparently communicate our findings.

- Based on these assessments, starting end-April 2011, banks will be required to maintain a core tier 1 capital ratio of 10.5 percent. Banks will report their capital adequacy ratios to the Central Bank on a quarterly basis. The Central Bank's assessment of banks' capital adequacy ratio will be made public at least semi-annually.

13. The question of whether burden should be imposed on bank sub debt is influenced by two factors: the quantum of capital the State has committed to support the institution and the perceived viability of the bank in the absence of receiving such capital. Forced burden sharing through legislation is possible and legislation is currently being prepared in this regard. Alternatively, in certain cases, a very deeply discounted liquidity management exercise might also be an appropriate option.

14. In addition, we will finalise proposals to strengthen the legal framework for dealing with distressed deposit-taking institutions in line with recent EU developments (including EU competition rules) and international sound practices. Such a special resolution regime will broaden the available resolution tools with the aim of promoting financial stability and protecting depositors. In particular, the draft legislation will (i) provide for the appointment of a special manager where, in the opinion of the Central Bank, an institution's financial condition has severely deteriorated; (ii) grant powers to the Central Bank for the transfer of assets and liabilities to other institutions; and (iii) create a framework for the establishment of bridge banks. We seek to submit draft legislation including the above-mentioned elements to Dáil Éireann by end-February 2011 (structural benchmark).

15. Moreover, we will continue the efforts to strengthen banking supervision by ensuring higher staffing levels and budget allocations in line with OECD best practices. We will enhance the risk assessment framework and raise the corporate governance standards. By end-September 2011, a report by an independent assessor on our compliance with Basel core principles for effective banking supervision will be made public.

16. We will also reform the personal insolvency regime for financially responsible individuals (including sole traders), which will balance the interests of both creditors and debtors. The objectives will be to lower the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline. The new legal framework will include a non-judicial debt settlement and enforcement mechanism as an alternative to court-supervised proceedings.

17. We will continue to provide means-tested financial assistance to limit the economic and social fallout of the crisis. The existing mortgage interest supplement scheme is crucial for providing temporary assistance to distressed mortgage holders. The scheme's administration will be centralised to ensure a more consistent application focusing on households that are most in need, and further modification will be introduced in the 2011 Social Welfare Act.

18. Our strategy for the credit union sector is based on three components. First, we will complete a full assessment of their loan portfolios by end-April 2011 (structural benchmark). Second, by end-April 2011, we will have ready a comprehensive strategy to enhance the viability of the sector. And third, by end-December 2011 we will submit legislation to

Dáil Éireann to assist the credit unions with a strengthened regulatory framework including effective governance and stabilisation requirements.

19. We will continue efforts to ensure the flow of credit to viable businesses, building on actions already taken under previous recapitalisations and NAMA legislation. Allied Irish Bank and Bank of Ireland have agreed, in connection with recapitalisation last March, to make available not less than €3 billion each for targeted lending for new or increased credit facilities to small and medium-sized enterprises in both 2010 and 2011 as well as funds for seed and venture capital and for Environmental lending. The lending policies and decisions of both banks are subject to review by the Credit Review Office, which enables businesses who have had credit refused or withdrawn, to apply for an independent review of the bank's decision.

20. NAMA is subject to an extensive range of statutory Governance and Accountability arrangements and these will be fully adhered to. Members of the NAMA Board must have relevant experience and expertise, and the work of the Board is supported by audit and other sub-committees. NAMA operations are also subject to statutory codes of practice. NAMA is required to prepare various reports, including quarterly reports of its activities, and these are subject to scrutiny by Oireachtas committees. The Comptroller and Auditor General audit the annual accounts and prepare reports on NAMA for review by the Public Accounts committee.

Safeguarding Public Finances

21. To continue with the programme of fiscal consolidation, a comprehensive National Recovery Plan 2011-14 was approved by the Government and published on 24 November 2010. This Plan forms the basis for the 2011 budget consistent with fiscal consolidation measures amounting to €15 billion, a 9 percent of GDP budgetary correction over the period 2011–14. Having stabilised the deficit, albeit at a high level, the steps announced in the Plan will place the budget deficit-to-GDP ratio on a firm downward path. While the debt-to-GDP ratio will remain at high levels for the next few years, it is projected to decline thereafter, underpinning debt sustainability. We also propose to keep under review progress towards meeting the Stability and Growth Pact targets.

22. Budget 2011 which will include adjustment measures of €6 billion, will be submitted to Dáil Éireann for passage on 7 December (prior action). As set out in the National Recovery Plan, most of this adjustment will come from the expenditure side. The capital budget will be reduced, partly through greater value for money in our infrastructure procurements. On current expenditures, we are pursuing public service numbers reductions through natural attrition and voluntary schemes, adjustments in public service pensions, and further savings on social transfers (from reductions in working age payments, reductions in universal child benefit payments and other reforms). Protecting the socially vulnerable at a

time of difficult economic adjustment remains a central policy goal. Current savings will also be realised from streamlining government programmes and through administrative efficiencies. Should these savings or the expected numbers reductions not materialise, we reserve the option to take further measures.

23. An income tax-led revenue package—sized at over €2 billion in a full year—will supplement the above expenditure measures in 2011. Over the past decade, the proportion of citizens exempt from income tax has risen to 45 percent and tax credits have doubled, resulting in a comparatively low burden of tax on ordinary incomes. This is no longer sustainable. Accordingly, we are widening the tax base, by lowering income tax bands and credits by 10 percent, and by reducing various pension-related tax reliefs. We are also taking action on other tax expenditures, and distortions arising from the existence of multiple levies.

24. To secure our fiscal targets, a number of fiscal measures have been identified for 2012–14. We will continue to rely on expenditure savings (€6.1 billion), led by current spending (€4.9 billion), as outlined in the National Recovery Plan. We are targeting further reductions in public sector numbers, social benefits and programme spending, and have anchored the prospective savings by publishing multi-year expenditure ceilings by Vote Group through 2014. We are also planning to move towards full cost-recovery in the provision of water services and ensuring a greater student contribution towards tertiary education, while ensuring that lower-income groups remain supported. In addition, we will accelerate the process of placing the pension systems on a path consistent with long-term sustainability of public finances. On the tax side, we will build on the base-broadening measures outlined above and establish a sound basis for sub-national finances through a new residential-property based site value tax. The Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

25. We are preparing institutional reform of the budget system taking into account anticipated reforms of economic governance at the EU level. A reformed Budget Formation Process will be put in place. Furthermore, we will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by end-July 2011 (structural benchmark). A Budget Advisory Council, to provide an independent assessment of the Government's budgetary position and forecasts will also be introduced by end-June 2011 (structural benchmark). These important reforms will enhance fiscal credibility and anchor long-term debt sustainability.

Raising the Growth Potential

26. We recognise the need to restore strong sustainable growth. The structural changes to the financial and fiscal sectors, described above, are critical for improving the prospects of economic recovery and raise the medium-term growth potential. Although, as is widely recognised, Ireland is a global leader in providing a business-friendly environment, the

National Recovery Plan includes a strategy to remove remaining structural impediments to competitiveness and employment creation. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, which will also support growth and promote jobs.

27. Specifically, we will continue to press ahead with other structural reform as set out in the Memorandum of Understanding on specific economic policy conditionality:

- We will promote service sector growth through vigorous action to remove remaining restrictions on trade and competition, and will propose amendments to legislation to enable the imposition of financial and other sanctions in civil law cases relating to competition.

- Building on the forthcoming report of the Review Group on State Assets & Liabilities the government will undertake an independent assessment of the electricity and gas sectors with a view to enhancing their efficiency. State authorities will consult with the Commission Services on the results of this assessment with a view to setting appropriate targets for the possible privatisation of state-owned assets.

- To reduce long-term unemployment and to facilitate re-adjustment in the labour market, we will reform the benefits system and legislate to reform the national minimum wage. Specifically, changes will be introduced to create greater incentives to take up employment.

Programme Financing

28. Ireland is facing large and medium-term balance of payments needs that arise from (i) substantial pressures on the capital account that need to be relieved, and (ii) the need to build up reserves to improve banks' ability to meet their large external debt rollover needs. The programme's success is dependent on substantive external financial assistance. This external financing will serve as a bridge during the implementation of the critical reforms to fundamentally restructure the banking system and restore fiscal sustainability. It is our view that, given Ireland's medium-term structural adjustment needs, an arrangement under the Extended Fund Facility (EFF) would be appropriate. Such an arrangement would also have the added benefit of a more realistic repayment schedule for Ireland.

29. Notwithstanding the large fiscal adjustment, we estimate the financing need to be up to €85 billion until the end of 2013. This includes a contingency element for bank recapitalisation. An amount of €17.5 billion will be covered by an Irish contribution through the Treasury cash buffer and investments of the National Pension Reserve Fund. We expect commitments from the IMF under the Extended Arrangement to amount to €22.5 billion and EU financial support from the European Financial Stability Mechanism/European Financial Stability Facility and bilateral arrangements to amount to €45 billion. Ireland will draw on

these resources in parallel throughout the programme period. While the envelope of resources to be provided to Ireland is a source of reassurance to the authorities and to financial markets, we plan to draw pari passu on IMF and EU financial support on an as needed basis. Moreover, if market access is restored on a sustainable basis, we would anticipate paying down the drawings made on an advanced schedule.

30. We are confident that the implementation of the fiscal and banking sector reforms will help the economy recover.

Programme Monitoring

31. Progress in the implementation of the policies under the programme will be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews and compliance with requirements under the Excessive Deficit Procedure (EDP). The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer balance (central government cash balance) excluding interest payments will be monitored through quarterly performance criteria and net central government debt will be an indicative target (Table 1). As is standard in IMF arrangements, there will be a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms will be monitored through structural benchmarks (Table 2). A joint EC-ECB Memorandum of Understanding specifies, notably, the structural policies recommended in the MEFP, and sets a precise time frame for their implementation,

32. As is standard in all Fund arrangements, a safeguards assessment of the Central Bank of Ireland will be completed by the first review of the arrangement. In this regard, the Central Bank will receive a safeguards mission from the Fund and provide the information required to complete the assessment by the first review. As a related matter, and given that financing from the IMF will be used to provide direct budget support, a framework agreement will be established between the government and the Central Bank of Ireland on their respective responsibilities for servicing financial obligations to the IMF. As part of these arrangements, Fund disbursements will be deposited into the government's account at the Central Bank.

33. We authorise the IMF and the European Commission to publish the Letter of Intent and its attachments, and the related staff report.

deposits with a maturity of post-September 2010[10]. While the guarantees have provided some relief to banks, they have not allowed them to restore their access to term market funding. The ELG Scheme has been prolonged to 31 December 2011 for all liabilities under the Scheme, subject to continuing EU Commission state aid approval at six-monthly intervals.

14. **The government also took action to strengthen banks' capital.** Given banks' difficulties to find a private solution to their capital needs, the government provided additional capital in cash or through promissory notes[11] to five domestic institutions, Irish Life and Permanent being the exception. A second measure the government took with a view to providing impaired assets relief to banks was the establishment of the National Asset Management Agency (NAMA, see Box 1). In total, some €46 billion (29% of GDP) has been injected in domestic banks over the period 2009-2010 (see Table 2). This amount does not include additional recapitalisations which will be identified under the EU/ECB/IMF Programme and injected over its course.

Table 2: Capital injections into Irish banks during the crisis (as of 28 January 2011)

Anglo Irish Bank ***(Nationalised in January 2009)***	**Total**: **€29.3bn** (18 1/3 % of GDP), including o €4 bn (June 2009) o €8.3 bn in form of a promissory note (March 2010), increased to 10.3 bn (May 2010). o €8.6 bn through a promissory note (notified June 2010, approved by the Commission on 10 August). o €6.4bn (of which €1.5bn already approved in August 2010) through a promissory note (December 2010),
Allied Irish Bank (AIB)	**Total: €7.2bn** (4½% of GDP), including o €3.5 bn (2¼% of GDP) in preference shares, via the National Pension Reserve Fund (NPRF) (February 2009) (*As part of the capital injection approved by the Commission in December 2010, all preference shares were converted into ordinary shares to increase the equity in the bank*) o €3.7bn cash investment by the NPRF in equity (December 2010)
Bank of Ireland (BoI)	**Total: €3.5 bn** (2¼% of GDP) in preference shares, via the NPRF (February 2009) of which €1.7 billion were converted into equity as part of BoI's capital raise in April 2010
Irish Nationwide Building Society	**Total: €5.4bn** (3½% of GDP), including o €0.1bn through special investment shares (March 2010) o €2.6bn in form of a promissory note (March 2010) o €2.7bn in form of a promissory note (December 2010)
EBS Building Society	**Total: €0.9bn** (½% of GDP) o €0.1bn through special investment shares (March 2010) o €0.25bn in form of a promissory note (June 2010) o €0.525bn in form of special investment shares (December 2010)
TOTAL	**€46.3bn (29% of GDP)**

Note: In addition, covered institutions benefit from the *bank guarantees* granted by the Irish authorities and have *transferred impaired property-related assets* to the bad bank "NAMA".
Source: Commission services

[10] The liabilities covered include: all deposits (to the extent not covered by deposit guarantee schemes in the State (other than the Credit Institutions Financial Support Scheme) or any other jurisdiction); senior unsecured certificates of deposit; senior unsecured commercial paper; other senior unsecured bonds and notes. In addition, a blanket guarantee will apply to all relevant deposits incurred or rolled-over by a participating institution from the time such participating institution avails of a guarantee under the ELG Scheme for the first time, regardless of type, nature or the identity of the depositor.

[11] Debt securities issued by the Irish State which qualify as core Tier 1 capital for the purpose of the calculation of Irish banks' regulatory capital adequacy ratio. The nominal amount of these securities is not disbursed immediately but over a 14 year period. The holder of these securities is also entitled to receive a coupon from the Irish State.

Government's Negotiation of Programme of Assistance and Interest Rate Savings

- The Government has successfully negotiated several key changes to the programme of assistance in series of phases:
    1. The MoU was amended also to allow for the jobs initiative, the restoration of the minimum wage and also to provide that no further loans were transferred to NAMA.
    2. The Government has successfully renegotiated the interest rate which will give rise to significant savings for the state. This in turn will improve our debt sustainability and reduce the cost of the bailout to taxpayers. This is very welcome news.
- As pointed out by Minister Noonan in Poland we have achieved significant clarity in our favour on interest since July and over the last week.
- The annual saving based on the full drawdown of the €45 billion available from the EU and bilateral loans are set out in the tables below. They set out the calculation of the original estimates (from July) and the more recent estimates based on last week's discussions.

Initial Illustrative Calculation *– based on initial illustrative assumptions of 2% reduction:*

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.00%	17.7	354
EFSM	2.00%	22.5	450
Bilaterals	2.00%	4.8	96
Total		45	900[1]

Updated NTMA estimates reflecting last week's announcements *– EFSF rate reduction is approx. 2.6% and EFSM rate reduction is just under 3%*

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.6%	17.7	450
EFSM	2.925%	22.5	650
Bilaterals	2.00% (not yet finalised)	4.8	100 (to be finalised)
Total		45	1,200[2]

[1] Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.
[2] Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.

- In addition, the cost of our IMF loans will reduce as a result of recent and forthcoming increases in our IMF quota. The NTMA has calculated the overall benefit of this interest rate reduction at some €1.9 billion. Some €30 million of this arises in 2012 and is included in the overall estimate of €900 million of interest savings for next year.

- Based on the above estimates for the changes to the EU and IMF elements of the loans, the overall saving based on the initial lifetime of the programme (which will be extended) would be over €10 billion.

- For 2012 the changes in the EU and bilateral loans combined with the impact of IMF quota changes amount to some €900 million.

- The average maturities of the loans will be extended – this has the effect, as pointed out by Commissioner Rehn on Friday of improving our debt sustainability and also of improving liquidity for Ireland.

- Furthermore Minister Noonan pointed out that it has been agreed at the weekend meeting that Ireland will get a prepaid margin of €600m on the EFSF returned in 2016. This had not been clear beforehand. While it is important to note that this margin return is already factored into the interest savings figures once all the programme funding is drawdown it does give rise to a €600m capital receipt in 2016 directly to the Exchequer.

Impact of interest rate reduction on adjustment for 2012

- These actions are very positive for Ireland and improve our debt sustainability but there is a need for us to be realistic as there are a lot of difficult decisions still to be made. Indeed, we only get the benefit of the interest rate reductions if we continue to meet our programme commitments. The Commission, when announcing the proposed change to our EFSM, rate cited the fact that Ireland is meeting its programme.

- This Government is committing to making these difficult decisions and restoring our sovereignty but we will continue to negotiate key elements of our programme, as appropriate.

The National Recovery Plan 2011-2014

What does the National Recovery Plan do?

The Plan provides a blueprint for a return to sustainable growth in our economy. In particular, it:

- Sets out the measures that will be taken to restore order to our public finances.
- Identifies the areas of economic activity which will provide growth and employment in the recovery.
- Specifies the reforms the Government will implement to accelerate growth in those key sectors.

Why do we need this Plan?

The gap between Government receipts and spending will be €18.5 billion in 2010.

- This gap must be filled by borrowing. Unless the rate of borrowing is reduced, the burden of debt service will absorb a rapidly increasing proportion of tax revenue.
- Moving towards a balanced budget is a prerequisite for future economic growth.

Reducing the budget deficit is necessary, but it will not, by itself, solve our economic difficulties. We must grow our economy by improving our competitiveness and build on our strong export performance.

Can we be optimistic about our economic prospects?

Yes, certainly. Our economy is emerging from recession:

- GDP will record a moderate increase this year on the back of strong export growth.
- Exports are expected to grow by about 6% in real terms this year, driven by improvements in competitiveness and a strengthening of international markets.
- Conditions in the labour market are beginning to stabilise.
- However, domestic demand remains weak as households and businesses continue to save at elevated rates and pay down debt.
- The current account of the balance of payments will record a small surplus in 2011, meaning that the economy as a whole is paying down external debt.

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The conditions for sustainable export-led growth are in place:

- Good infrastructure.
- High-quality human capital.
- Tax policies which are favourable to entrepreneurship, investment and work.
- Adequate credit availability for viable businesses.

The Plan projects that real GDP will grow 2.75% on average over the 2011– 2014 period.

- 90,000 (net) new jobs will be created over the period 2012-2014.
- Unemployment will fall to below 10% by 2014.

How much more budgetary adjustment is needed?

- Adjustments of nearly €15 billion have already been implemented over the past two years. These measures have succeeded in stabilising the budget deficit.
- An additional €15 billion package of measures is required to bring the deficit back below 3% of GDP by 2014.
- This package will comprise ⅔ expenditure and ⅓ revenue measures.
- €6 billion will be front-loaded in 2011.
- Deficit will be reduced to 9.1% of GDP in 2011. Debt to GDP ratio will peak at 102% in 2013 and will fall to 100% by 2014.

Won't budget adjustments of this scale kill off any potential recovery?

No, the economy is projected to grow 2.75% on average over the 2011– 2014 period.

The adjustment will weigh on domestic demand, but its overall effect will be mitigated by:

- The economy's high propensity to import.
- Positive effect of budget adjustments on competitiveness and confidence.

What can the Government do to boost growth?

There are two pillars to the strategy for competitiveness, growth and employment:

- Remove potential structural impediments to competitiveness and employment creation.
- Pursue appropriate sectoral policies to encourage export growth and a recovery of domestic demand.

Specifically, the Government will:

- Reduce the minimum wage by €1 to €7.65.
  - High minimum wage is a barrier to job creation for younger and less skilled workers where unemployment rates are highest.
  - Will still be among the highest rates in the EU.
- Reform welfare system to incentivise work and eliminate unemployment traps.
- Re-invigorate activation policies to ensure that unemployed people can make a swift return to work.
- Promote rigorous competition in the professions and measures to reduce legal costs.
- Take decisive actions to reduce waste and energy costs faced by businesses.
- Enhance availability of technological infrastructure, in particular next generation broadband networks.
- Lead efforts to reduce office rents in both the private and public sectors.
- Increase efficiency in public administration to reduce the costs for the private sector.
- Implement sector specific measures to assist an increase in exports as well as an increase in domestic demand.
- Support innovation through the innovation fund and other enterprise supports and through our tax system.

Why must we reduce Expenditure?

- Significant increases in public expenditure during the boom.
- Ratio of day-to-day expenditure to GNP has jumped from 28% during the boom years to 44% in 2010 – this is unsustainable.

Current expenditure will be adjusted by €7 billion and capital expenditure by €3 billion.

Social welfare, pay and programme spending each account for around one third of total expenditure - reductions in each of these areas are unavoidable.

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Government will:

- Reduce the cost of the public sector pay and pensions bill, social welfare, and public service programmes.
- Achieve savings in social welfare expenditure of €2.8 billion through a combination of control measures, labour activation, structural reforms, further reductions in rates as necessary and a fall in the Live Register.
- Cut public service staff numbers by 24,750 from end-2008 levels, back to levels last seen in 2005.
- Implement overall payroll adjustments of €1.2 billion by 2014.
- Introduce a reformed pension scheme for new entrants to the public service and reduce their pay by 10%.
- Make more effective use of staffing resources with redeployment of staff within and across sectors of the public service to meet priority needs.
- Reform work practices to provide more efficient public services with scarcer resources.
- Increase the student contribution to the costs of third level education.
- Introduce a charge for domestic water by 2014.
- Reform and update the existing budgetary architecture.

These reductions will bring expenditure back to its 2007/2008 level. Working age welfare rates will be reduced to slightly above 2007 levels.

Why do taxes have to rise?

Tax receipts in 2010 will be around 35% lower than in 2007, the steepness of the fall reflecting the over-dependence on property and construction-related revenue sources during the boom years.

Nearly half of income earners in 2010 will pay no income tax. This is not sustainable.

A fundamental principle of the reform outlined in this Plan is that all taxpayers must contribute according to their means. Those who can pay most will pay most but no group can be sheltered.

Is Ireland about to become a high-tax economy?

No, tax burdens are not going back to 1980s levels. The changes in the Plan will bring the income tax structure back to what existed in 2006.

What taxation measures will the Government introduce?

Government will:

- Maintain the 12½% corporation tax rate; this will not change.
- Raise an additional €1.9 billion through income tax changes.
- Implement pension-related tax changes to yield €700 million, with €240 million in tax savings on the public sector pension related deduction.
- Abolish/curtail a range of tax expenditures yielding €755 million.
- Increase the standard rate of VAT from 21% to 22% in 2013, with a further increase to 23% in 2014. These changes will yield €620 million.
- Introduce a local services contribution to fund essential locally-delivered services. This will yield €530 million.
- Increase the price of carbon gradually from €15 to €30, yielding €330 million.
- Reform capital acquisitions and capital gains tax to yield an additional €145 million.
- Transform BES into a new Business Investment Targeting Employment Scheme.

Why should we support this Plan?

Our economy will recover. Detailed policy measures identified in the Plan will build on our strengths and develop other sectors to provide a balanced economy and employment for our citizens. Our future prosperity rests upon the implementation of this Plan over the next four years.

NTMA Advisory Committee

12 January 2011

Item 2

EU - IMF Funding Programme

1. EU/IMF Programme and planned disbursements in the first quarter and in 2011

The EU-IMF Programme for the period to 2011-2013 has provided for €85bn in total, of which €50bn is intended to be available to meet the Exchequer's direct needs and €35bn for the banking system, but this would also be channelled through the Exchequer to the extent it was drawn upon. Some €17.5bn of the Programme comes from the Government's own resources; €10bn from the National Pensions Reserve Fund and €7.5bn from the Exchequer's cash buffer. In summary the package is as follows:

		€bn
EU	– EFSM*	22.5
	– EFSF*	17.7
	– Bilateral Loans	4.8
IMF		22.5
Total EU/IMF		**67.5**

Government resources:

	€bn
NPRF	10.0
Exchequer Cash	7.5
Total Gov't resources	**17.5**
Total Programme	**85.0**

The Exchequer's requirements in 2011-2013, excluding any capital injection into the banks, are:

	2011	**2012**	**2013**	**Total**
	€bn	€bn	€bn	€bn
Budget Deficit	17.7	15.1	11.0	43.8
Bond Redemptions	4.6	5.8	6.1	16.5
Short Term Debt	6.9	-	-	6.9
Total	**29.2**	**20.9**	**17.1**	**67.2**

*EFSM is the EU Commission's borrowing facility
EFSF is the SPV borrowing entity of the euro area

Assuming absolutely no funding by the Exchequer, the €50bn available for Exchequer funding under EU-IMF Programme would suffice until end 2012. In fact, we would expect retail debt to raise some €2 billion per year, and depending on market conditions we would also expect to raise some funding through the sale of annuity type bonds to the domestic pensions industry. Some short term paper funding may also be possible. In any event, we are funded through end-2012 without a requirement to return to the bond markets.

The quarterly profile of the Exchequer's needs in 2011 is as follows:

	Q1	Q2	Q3	Q4	Total
	€bn	€bn	€bn	€bn	€bn
Budget Deficit	8.1	4.5	3.2	2.0	17.7
Bond Redemptions	-	-	-	4.6	4.6
Short Term Debt maturing	5.4	1.4	0.1	-	6.9
Total	**13.5**	**5.9**	**3.3**	**6.6**	**29.2**

The schedule of drawdowns has been agreed with the IMF and EU for the first quarter of 2011. The details are:

IMF	€7.9bn
EFSM	€8.4bn
EFSF	€3.3bn[1]
Total	**€19.6bn**

These drawdowns include €10bn for the banking sector, leaving €9.6bn for Exchequer funding. In effect for Q1 we would need to draw on only about €3.9bn of the €7.5bn Exchequer cash included in the package. The exact details of the drawdowns for the remainder of 2011 will be discussed with the external authorities after Q1. However, it is unlikely that the €10bn of NPRF assets included in the EU/IMF Programme will be required in 2011.

The disbursements in the first quarter reflect in part the needs of the EFSM and the EFSF to issue in the market as they had indicated they would, and to issue in benchmark size. The EFSF is a new issuer and while the EFSM has issued before the scale of its issuance will significantly increase. It was therefore deemed appropriate that they issue early in the year when markets are liquid and demand is high due to investor cash flow. The EFSM raised €5bn of 5 year funds on 5 January at a cost to Ireland of 5.51%, including a margin of 2.925% for ESFM. The EFSF will follow in late January with another 5 year benchmark issue. It is intended that later in the quarter the EFSM will also issue a 7 or 10 year bond in a €3.4bn size. The IMF will also disburse SDR 5bn (€5.8bn) on 18 January and a further SDR 1.8bn (€2.1bn) in March which gives a total for the first quarter of SDR 6.8bn (€7.9bn). On the basis of current market rates the cost of the IMF funds to be disbursed on 18 January would be 6.04% when swapped into equivalent euro rates.

It was the original intention that the EFSF would issue a 5 year bond as its first benchmark issue and the EFSM a 10 year benchmark. The change of the EFSM issue from a 10 year to a 5 year issue, leading to both the EFSM and EFSF issuing 5 year benchmarks, is due to the rise in cost of the 10 year borrowing. When the EU/ IMF package was announced in late November 2010 it was estimated that the cost of the EFSM funds would be 5.7%, based on an average 7.5 year maturity and market rates at that time. However, since then the base cost of borrowing, as represented by the swap curve, has

[1] Due to the significant overcollateralization the EFSF disburses 67% of the 5bn issued

increased by 30bp while the margin over swaps for borrowers such as EFSM and EIB has increased by 10-15bp. In addition, the cost of borrowing for ten years is about 27bp greater than for 7.5 years. In all, this raised the cost of a 10 year issuance to almost 6.5% and there was a risk that new issuance premium could drive the cost even higher. Against this background it was decided that a 5 year issue would be preferable.

2. Banking System

At its most recent meeting the Committee was briefed on the Financial Sector Reforms which are a part of the conditionality attaching to the EU/IMF Programme. These reforms cover recapitalisation measures, deleveraging measures and reorganisation of the banking sector. Developments in these three are considered in the following paragraphs.

Recapitalisation

For the surviving domestic covered institutions (AIB, BoI, EBS, IL&P), minimum capital requirements are set at 10.5% with an initial requirement to capitalise to a core tier 1 level of at least 12%. An enhanced Prudential Capital Assessment Review (PCAR) is to be complete by end-March 2011, following which any capital shortfall below the 10.5% minimum core Tier 1 level will have to be made good.

An immediate effect of the recapitalisation requirement is that AIB was required to raise an additional €5.3bn, or €9.8bn including the amount already required by end-2010. The State subsequently injected €3.7bn prior to year-end, leaving a further €6.1bn to be raised prior to the specified deadline of end-February 2011.

Bank of Ireland was required to raise €2.2bn of Core Tier 1 capital and has to date generated some €700m through a liability management exercise, leaving €1.5bn to be raised by end-February 2011. EBS was required to raise an additional €0.4bn and IL&P an additional €0.1bn. To the extent that these institutions cannot generate capital from other sources, it will have to be provided by the State.

The Credit Institutions (Stabilisation) Act 2010 was enacted in December to provide powers to the Minister for Finance to intervene in covered institutions in certain circumstances. Using powers under this Act, the Minister directed AIB to issue shares for a cash injection of €3.7bn from the NPRF prior to year end. This investment by the NPRF is a Directed Investment. The NPRFC, as a result, now holds a 93% economic interest in AIB.

Deleveraging

The Central Bank is to complete a Prudential Liquidity Assessment Review (PLAR) for 2011 outlining measures to be implemented with a view to steadily deleveraging the banking system and reducing the banks' reliance on short term funding. The Programme specifies that ambitious loan to deposit ratio targets are to be set, to be achieved by end 2013. The Committee will note that, while a loans to deposits ratio is a poor measure of funding stability, it is the measure chosen by the international authorities as their preferred target. The achievement of ambitious deleveraging targets without excessive cost to the State will be heavily dependent on market conditions, in particular the buyer

appetite for assets to be offered for sale by the Irish banks. It is notable that the Programme states that "Compliance with the PLAR benchmarks will be monitored and enforced by the Central Bank taking account of prevailing market conditions."

Reorganisation of the banking sector

It is agreed in the EU/IMF Programme that, within the context of a comprehensive reorganisation and downsizing of the banking sector, the strategy will identify the appropriate path to ensure that the banking system will operate without the need for further State support. In this context, work is currently under way to resolve Anglo Irish Bank and INBS through a disposal of their deposit portfolios and certain other of their assets and liabilities. The remaining portfolios will then be run off or otherwise disposed of over time. The Credit institutions (Stabilisation) Act, 2010, already mentioned, will support reorganisation measures as necessary. The Act also enables the imposition of burden sharing on holders of subordinated debt in the covered institutions should that be considered both desirable and necessary.

Bank funding and liquidity

Bank funding and liquidity was not addressed directly in the EU/IMF Programme. The programme considered that the measures outlined above will restore the banking system to a position where it will once again be able to function on a standalone basis. We remain concerned in this respect as the huge scale of the liquidity shortfall in the banking system is such that it will prove very difficult to re-establish investor willingness to place funds in the system, absent convincing backstop support in the first instance. Even an Irish Government guarantee has proven insufficient to retain overseas deposit funding in the system in the latter part of 2010 in the context of falling credit ratings for Ireland. Absent a marked change in international investor sentiment towards peripheral Euro countries generally and towards Ireland in particular, there must remain a very real concern that the funding and liquidity crisis currently affecting the Irish banking industry will not be resolved by the measures contained within the EU/IMF Programme. In particular, we felt that an explicit commitment by the ECB to liquidity support for the Irish system in the context of the Programme would have been beneficial.

THEME: R5

Clarity and effectiveness of the Government and Oireachtas oversight and role

LINE OF INQUIRY: R5b

Appropriateness of the advice from the Department of Finance to Government and the use thereof by Government

ROINN AN TAOISIGH

(33)

Uimhir.................................

To: 1. Secretary General
2. Taoiseach

From: Mary Doyle

Taoiseach
This is the note I mentioned to you earlier. We can incorporate in papers for next week
[illegible]

10/09/08

Re: Housing Market - Policy Options

Summary

The Department of Finance presentation today outlines suggested measures but makes no recommendations.

For reasons set out below, the most promising options would seem to be:

- **accelerated introduction of an affordable housing shared equity product** administered by the Affordable Homes Partnership; this has been in the pipeline for some time, would better help meet affordable housing needs and might boost market confidence. Delivery mechanisms also need careful thought as local authorities role remains highly problematic. However many potential buyers will still wait until they believe prices have bottomed-out.

- incentives to stimulate investment in household **energy efficiency**, whether through grants or tax incentives (e.g. a link to Stamp Duty might have a similar psychological impact to the VRT\Motor Tax reforms); this would use similar skills to house construction and give benefits in greenhouse gas reduction

- targeted **re-training** and upskilling programmes through FÁS for construction workers who lose their jobs; will require diversion of resources including those currently used for apprenticeship training

- **area-based tax incentives** which would seek to stimulate investment in sustainable urban development in Gateways; once targeted appropriately this could meet both economic and environmental goals

- enhanced **assistance programmes for families** which are in risk of house re-possession perhaps through MABS (UK have develop targeted responses on these lines) – need to discuss with D\SFA

Rational for any Intervention

A range of possible interventions have been suggested but there is a need for clarity on the purpose of any measure.

The core problem at present is the expectation of further price falls which means that purchasers are holding-off and banks are reluctant to lend. This is exacerbated by the 'credit crunch' which has reduced the banks' capacity to lend in any case.

The housing market peaked in July 2006 in terms of price acceleration and commencements and actual prices peaked in February 2007 and have fallen since then (tsb/esri index).

OECD data suggests that in a property crash real house prices give up an average of 70% of the rise in prices during the boom (Irish house prices appear to have fallen by between 25% and 33% in real terms).

OECD suggest that a crash usually lasts 5-7 years because:

- home-owners are slow to reduce prices and prefer to wait for nominal prices to recover through inflation
- falling property prices affects wider economic performance through wealth and confidence effects
- banks face protracted difficulties with bankrupt developers and home-owners in negative equity.

The pace of decline in the Irish market may mean truncation of the cycle, but there's clearly still some way to go.

Estimates of underlying housing demand and the extent of an 'overhang' in the market can only be tentative. They make assumptions about migration which are questionable during a serious economic downturn. (For example, immigrants returning home will free-up housing stock) There is a strong case for letting market forces play out. Tighter credit conditions is partly how the price adjustment takes place.

(A different rationale for interventions to stimulate activity in the housing market could be in relation to stability in the financial and banking sector but this raises a different set of issues.)

International Experience

Lessons from international experience suggest:

- a fast correction is preferable to a long, drawn-out process
- it is not in the interest of the economy to prevent the inevitable fall in construction activity and prices towards sustainable levels

- governments should seek to deliver productive infrastructure projects which will also bolster short-term demand and employ spare construction workers
- governments should help retrain unemployed construction workers for more productive sectors
- there may also be a case for more assistance for families who fall into serious problems with mortgage repayments.

Recommended Options

A list of some specific measures which have been suggested in different quarters is below. In light of comments above, the most promising options would seem to be:

- **accelerated introduction of an affordable housing shared equity product** administered by the Affordable Homes Partnership; this has been in the pipeline for some time, would better help meet affordable housing needs and might boost market confidence. Delivery mechanisms also need careful thought as local authorities role remains highly problematic. However many potential buyers will still wait until they believe prices have bottomed-out.

- incentives to stimulate investment in household **energy efficiency**, whether through grants or tax incentives (e.g. a link to Stamp Duty might have a similar psychological impact to the VRT\Motor Tax reforms); this would use similar skills to house construction and give benefits in greenhouse gas reduction

- targeted **re-training** and upskilling programmes through FÁS for construction workers who lose their jobs; will require diversion of resources including those currently used for apprenticeship training

- **area-based tax incentives** which would seek to stimulate investment in sustainable urban development in Gateways; once targeted appropriately this could meet both economic and environmental goals

- enhanced **assistance programmes for families** which are in risk of house re-possession perhaps through MABS (UK have develop targeted responses on these lines) – need to discuss with D\SFA

Other Possible Measures

Sherry Fitzgerald proposals

1. **Shared Home Equity (Gov lend 17% of price of new home)**
    - no link to affordability proposed
    - Government would rank behind bank on disposal therefore bears risk of house price decrease
    - affordable housing equity product would do something similar but targeted on affordability problem

2. **VAT refund to purchaser of existing new housing stock:**
    - measure to incentive short-term sales
    - suggests a refund of 3.5% of VAT (rate is 13.5%)
    - assumes that buyers aren't expecting an even greater fall in price
    - delays price adjustment required in market

3. 100% FTB Mortgage Interest Relief up to €350,000

- still an incentive for buyers to wait for price fall
- delays price adjustment required
- FTBs will already gain from falling prices
- large deadweight factor

4. Housing Associations

- proposal isn't specific but suggestion seems to be increased funding for voluntary housing sector
- already providing substantial State investment
- short-term impact limited, although continued pursuit in long-term worthwhile

Draft D/Finance Memo

5. **Equity-based Affordable Housing Scheme** (as above)

- based on proposal in AHP report
- replace four current schemes (shared ownership, '99 Affordable Housing Scheme, Part V and Affordable Housing Initiative) with a single equity-based scheme
- state retains equity with full clawback (unlike existing schemes) which actually worsens position for purchaser
- risk of price decrease on Government's equity share
- serious delivery challenges (legislation, capacity of local authorities)
- this is a sensible, overdue reform which may stimulate confidence by being more accessible – however buyers still won't enter the market if they believe prices will fall further

6. **Extension of Local Authority Mortgages**
   - this is currently very limited (maximum ban of €185,000) with a discounted rate (0.5% below commercial lending) and is only available where person has been refused by a bank and building society
   - a new, parallel scheme would be available to those above current income limits, paying commercial rates
   - state is effectively entering mortgage business through local authorities and Housing Finance Agency
   - capacity of local authorities to manage and deliver a large-scale scheme must be unclear

7. **Long-term Lease Arrangements**
   - expansion of State procurement of social housing under the Rental Assistance Scheme (RAS)
   - may be worth doing as part of overall social housing provision but involves State expenditure and therefore affects GGB; only possible by prioritising expenditure fm elsewhere
   - might remove some of overhang from market but impact likely to be limited (people involve may well be renting already with rent supplement)

<u>IAVI Letter</u>

8. **s23-type relief for unsold housing units**
   - would delay necessary price adjustment
   - very hard to administer effectively (how determine what it applies to?)
   - runs counter to overall tax incentive policy
   - likely to very expensive as a tax expenditure

Others

9. **Stamp Duty exemption / reduction for limited period (eg. one year)**
   - UK have done this
   - may generate activity but delay necessary price adjustment by bringing forward some demand with resulting price fall once it expires
   - only affect second-hand homes in any case in Ireland

10. **Joint Industry-Developer interest free loan for part of house value (as in UK 'Homebuy Direct')**
    - this would mean Government assisting developers to implement schemes like that announced last week
    - delay necessary price adjustment
    - need to examine how it would operates in practice but essentially involves State bearing part of risk of default

THEME: R5

Clarity and effectiveness of the Government and Oireachtas oversight and role

LINE OF INQUIRY: R5c

Analysis of the key drivers for budget policy

Statement of John Moran, Secretary General (2012-2014)

Dear Members of the Committee

I joined the Central Bank only in July 2010 to restore credibility to Ireland's supervision of wholesale banks, becoming more centrally involved only in 2011 when appointed Head of Banking Policy and Restructuring and later (2012) Secretary General of the Department. For that reason, I confine my observations to matters arising after 2010.

I have been directed to make a written submission on nearly 20 diverse topics of inquiry. It would not have been possible given the restrictive word count to do justice to each. So, rather than provide short (and probably not so instructive) text for each topic, I have taken the liberty to make more general observations pertinent to the range of items.

My observations are presented under the following headings:-

- Ireland's crisis was not just a banking problem but very much a fiscal one
- Burning the bond-holders - not the silver bullet solution
- The civil service and the political process
- The Department's relationships with the NTMA and the Central Bank
- Other changes made in the Department during my three years there.

A Our crisis was not just a banking problem but very much a fiscal one

Some people like watching thriller TV programmes or movies, accustomed to plots with high-suspense and goodies or baddies. They might wish for the drama of Ireland's economic collapse to be couched in terms of irresponsible over-paid bankers, reckless developers, the night of the bank guarantee, and the burning of these faceless bondholders. It makes good TV as they say!

A simplistic rhetoric has therefore been entertained that if we had not had a collapse of Lehman Brothers and the Irish banks and had burned the bondholders, we would have had no issues.

True, our property price collapse led to awful widespread destruction of personal wealth and unemployment.

But the sad reality is that an acute lack of fiscal capacity at Governmental level removed flexibility in easing the impact of those problems. The fiscal rectitude we are experiencing since, was a necessary result of the terrible and perilous structure of Ireland's fiscal profit and loss (or if you like taxes and spending). That P&L collapsed causing recurring deficits to be painfully funded by piling yet more debt onto the back of future generations. As we come out of this crisis, this debt will end up being be more than twice the net debt expected from the bailout of the banks.

This all should not be forgotten.

Annual current spending (sadly, recurring) and reductions (again, recurring) in the annual taxation burden had been set at levels out of all appropriate relationship with the quantum of sustainable revenues of the state in the early years of the 21st Century.

Budgetary spending decisions had been funded in the years leading up to the crisis from what were very fragile revenue sources, built on the quicksand of an economic performance overly

concentrated on one over-blown sector - property. The country was then building perhaps 50,000-60,000 houses surplus to its medium term annual requirement. Spending had been increased assuming that this excess activity was not just justified at that time, but worse, would continue into the future. No one was planning for what might happen to stamp duty, PAYE revenues and social welfare payments or even to spending or wages in the economy and people's standards of living if construction were to resize to 25,000 units of output, a more sustainable quantum – even if we had managed a soft landing on property prices.

Second order impacts arising from excessive public sector wage levels and unsustainable property prices had also in turn led to excessive wage demands in the private sector and excessive costs in the real economy. Even parts of the economy which should have been doing well in a then growing global economy were in fact losing market share and had become uncompetitive.

It is true that it is important to understand why the government, the civil service, the regulator or even the banks themselves had not done more to restrict the excessive growth of the property market and prevent the dramatic collapse of the economy and the banks.

It is important to know why and how the government took decisions around the bank collapse which added further pressure on the State's funding capacity.

But I believe it is equally important, and perhaps even more important, that we understand for future proofing our state what was it in the structure, operation, and DNA of the organs of our state, the political system, the civil service, the broader public sector that allowed this precarious fiscal situation to develop. Looking at decision processes related to the collapse of the banks will be informative for that more general question too.

Had we not had to fund large fiscal deficits for 2010 and for the foreseeable future thereafter, the State's negotiating power either with the international markets or indeed with the European and IMF backstop funders would have been very different. It might have helped to avoid being shut out of markets and to have avoided a troika bailout entirely.

But that was not to be. A situation had been allowed to develop in the years running up to the crisis such that, without external funding from some source, the lights would have had to be turned out, not just in the banks who should have been able to rely anyway on the support of the ECB as liquidity provider of last resort, but in the public services of the country. This scenario is being re-enacted by Greece as I write this submission.

Why had we not structured our tax system more sustainably? Why had non-recurring stamp duty not been sensibly converted into annuity tax revenues like property tax or water charges? Why had unusually high stamp duties and PAYE taxes from an overblown property sector not been put into a rainy day fund for unemployment payments when things would not be so rosy? Why were the windfall gains spent to throw oil on the fire itself?

Had these alternative routes been taken, how much less painful might the last couple of years have been when the rug was taken out from under our fragile structure by the rapid withdrawal of international wholesale funding in 2008?

Where was the debate recommending these alternatives, which might not have been so politically popular? How did the decisions get made? Why did no political party manifesto contain proposals for the introduction of property taxes, charges for the consumption of water, more appropriate burdens of sustainable taxes to pay for necessary public services, the reductions of public sector pay

back to long term sustainable levels? And when we say the Irish public were blameless, ask would we have voted for such a Government in the 2007 election?

These type of questions could form a helpful backdrop to the inquiry's assessment of the robustness of our governance structures, looking forward.

B Burning Bondholders – not a Silver Bullet Solution

There are many reasons to justify why senior and not just junior creditors might have borne more of the cost of the collapse witnessed in the Irish economy and banking system. There are others which justify the longer game plan of keeping the EU and IMF authorities on side supporting the recovery.

But in rushing to over emphasis the import of this decision, let's not lose sight of a simple fact much over-looked in ill-founded public debate.

Producing a 3 billion reduction of current deficits (otherwise required to be funded by yet more annual borrowings) requires austerity measures with repeating annual impact. The reduction is not avoided by a once off decision to not repay say 3 billion to Anglo senior bondholders. Also, that decision does not generate cash income to pay excessive government expenditure as would by comparison a 3 billion dividend from Bord Gais. The decision just means our loss would be 3 billion less in the future. Not paying it would simply have meant we would have had 3 billion of borrowing not 6 billion in that first year. As the deficit continued, we would still have had additional new borrowings of 3 billion each year thereafter.

Indeed, a very unfortunate coincidence of numbers helped fuel the ill-founded public debate since the amount to be repaid on the promissory note was almost equal to the amount of the recurring saving needed to be achieved for that year's budget. Refinancing the promissory note payment with longer dated borrowing, did not prevent the state borrowing more money to make 3 billion of social welfare payments. Conversely, not repaying the promissory note would not have generated cash income to pay for that 3 billion of payments and avoided borrowing to do so.

Furthermore, when bondholders were repaid, they were repaid essentially from funds borrowed by the banks themselves. Indebtedness at the level of state owned banks was generally replaced by new bank borrowing by those banks (typically from the ECB), to be repaid in time from the activities of the bank, not tax revenues.

Only when the bank had to take capital from the state and there was no likelihood of recovering that money could one really say that the state (i.e., we taxpayers) had really funded the payback of the bondholders.

Put another way, burning bondholders might have simply generated a smaller ongoing debt number. Paying them with borrowed state funds, only increased the annual fiscal effort during recent years by the amount of the interest payable on the debt incurred for related bank capitalisation.

In the extreme, not paying 30 billion of capital to IBRC and reneging on the promissory note would not as is sometime suggested have generated a current day windfall which could have been distributed to the population in 2013 to ease austerity. It would merely have meant that we would not have the burden of the long term low cost borrowing which replaced it but allows us to absorb this loss economically over a longer period into the future.

Would, however, a state which had defaulted on its commitments be now able to borrow at the historically low rates available to Ireland for new borrowing? Recall that a one percent reduction in average interest rates saves around 2 billion per annum to our budget.

I fear that much of the public debate around this issue has been misplaced and the inquiry would do well, to clarify this matter once and for all when it assesses the cost of the crisis and sharing of the impact.

C The Civil Service and the Political Process

I wish also to raise some system-wide issues which struck me during my tenure as Secretary General.

I am not the first to identify these issues but I do so to share my somewhat unique perspective as a recent "outside" holder of a Secretary General position.

These items may merit consideration by the Inquiry as it examines broader issues:-

- Firstly, I found it surprising in 2011, how little debate on strategic issues for Ireland was, or could be, led publicly by civil servants. I was very fortunate to have a Minister willing to let me engage in that type of debate but it seems other Ministers might even have openly discouraged this in the past. Did they fear a loss of their own public air time?

  Officials have been criticised for not engaging more outside their own departments but when they do venture out into public debate, are they supported by the public and their public representatives or are they instead criticised and attacked almost as political targets especially when they are expressing uncomfortable truths? Thought should be given to what is in Ireland's best interests.

  My own experience was to suffer (what I still consider to be) unacceptable interference by the media into my personal life when I dared to stimulate discussion on key choices facing our urban planners and to be subjected to inaccurate public criticism by some even then current politicians for stating facts in a neutral but truthful way about repossession statistics in the country. Unless the system robustly defends (not attack) civil servants acting in good faith, is it fair to expect them to be more vocal and point out the alternatives, however unpopular, to the political choices or to protest loudly when perhaps a wrong decision is being contemplated?

- It was surprising too to me how little proactive debate about strategic longer term choices for Ireland was taking place even in private within the corridors of power in ways that involved the full broader leadership team of all of the government departments.

  Should our political system encourage this more or permit the time to be crowded out by an agenda dictated on short termism? Do we really have the right structures as a state to encourage wide ranging cross disciplinary debate about future spending priorities or infrastructural needs or the structures of our economy?

  When spending is broken up rigidly using departmental expenditure headings based on last year's spend and holistic spending choices are hosted in a different department than that where analogous tax expenditure decisions are made, do we have the right structure to identify weaknesses or for reformative decisions permitting reallocation of resources to new

or longer term or less visible priorities? The housing sector issues we faced in 2006-2007 and those we have again in 2015 show how root and branch cross-departmental action and resource reallocation from some budgets may need to be involved to avoid significant negative impacts for other budgets like social welfare. Does our system permit this?

- Elected representatives have a nature and role different to those employed in public administration, whether for a fixed term or for their entire career. I observed though in some quarters a surprising lack of equilibrium between the perception of relative positions of the political decision makers and the public service (especially the civil service). I suggest that it is important for the inquiry to question if we have achieved an unqualified environment of mutual respect to encourage truly free debate across the system.

- I suspect few of the citizens of Ireland have taken the time to discover how our Cabinet really works in practice. Yet, this is the primary hub of decision making, where not just the decision about the bank guarantee took place but indeed all major government decisions.

  Is it the right choice in 2015 that civil servants from relevant departments are excluded from the debates at Cabinet? What if during the debate someone raises a novel but detailed point not addressed in the supporting papers? Should those armed with the background technical detail to address that be typically excluded? Should Ministers well-versed in one department's activities be expected without the presence of some of their own civil servants who might have broader experience to be held responsible collectively for all decisions? Should exceptions be made if the government memo cannot be circulated to all other departments a couple of weeks beforehand for comment? Naturally, this becomes less critical as a particular Cabinet matures and develops greater experience, but how well can it really work in the first couple of weeks of each new Government?

  When I came to the Department in 2011, I had no reason to imagine it to be so. It seemed natural that I was asked to lead over two nights a seminar to brief those cabinet members with questions on detailed technical issues related to the fundamental and complex bank restructuring and the recapitalisation decisions of March 2011. I thought it was always like that but it seemed not so. My early surprise instead was that I was not expected to present the material officially the following day at Cabinet and participate and help any debate. Instead I was asked to wait outside while the debate took place.

  Each system has its own merits. I just mention this as it was in stark contrast to how some other high level decision fora operate, for example, the Central Bank Commission. There, for the same issues in 2011, key staff were involved in the prior evening's seminar and also the discussion at the Commission for that agenda item, even if they might not be present when the actual "go" "no-go" decision takes place after the debate.

  Is it right to retain in 2015 traditions developed when perhaps the world was less complicated, fast and inter-connected?

- Another interesting aspect of the operation of Cabinet and the sub-committees of Cabinet is how status updates of the deteriorating economic and banking system health were coming to and being discussed or not by the cabinet ministers and their respective officials in 2007 and 2008.

When the final critical time sensitive decisions had to be taken, were the Ministers already well informed about all of the background, even if the exact tactical decision and precise supporting facts might not be available along the way?

Were periodic health checks of the Irish economy, of the world economy, reaching the government ministers and being debated together even if no specific decision needed to be made?

Did the absence of a state-wide risk assessment framework, a system wide risk register and risk committee, of course, mean that it was unlikely to have a government memorandum to trigger this discussion formally at Cabinet?

Are things better now in terms of a Cabinet spending time on periodic reviews of the performance of the system? Or is debate only triggered by a memorandum to require specific political action/decision, where a specific piece of legislation is coming for approval or where some report into the latest political issue has been published or needs to be commissioned?

Certainly, the quarterly review of the troika process and the periodic reviews of the Action Plan for Jobs are examples of a good practice. How much cross Cabinet debate takes place though when the annual reports of departments are presented (notably, in the absence of the relevant Secretary General), to sign off on the output of those departments and their priorities for the upcoming years? How well do Cabinet colleagues point out to a Minister gaps in his planned work-scope to make sure nothing important falls between the cracks? Do the Cabinet debate together the Quarterly Financial Stability Reports, for example, from the Central Bank, reports from the OECD, from the IMF when they are published?

- Another surprise was to discover that former governments seemed, at least so the story goes, to have discouraged (even banned) the idea of meetings of secretary generals as a group to discuss policy unless their Ministers were present.

I had expected to find much more robust debate among the civil service team as a leadership group of the issues facing the country. I would have expected to equally see fora for the civil service leadership to debate the same issues I had just mentioned above, the IMF or OECD and other reports on Ireland, the Central Bank or Department of Finance's views of the state's finances, the Department of Public Expenditures views of priorities for spending to future proof the country for the future and so on.

Is it happening at the Cabinet table for a period beyond the next election? If it is not happening there nor at Secretary General level, where could it happen? Is it appropriate if the vacuum is being filled by cross Ministerial political advisor discussions only? What about only by less structured reactive bilateral, perhaps tri-lateral, departmental discussions?

The troika process meant I did not notice this vacuum quite as quickly as I might in my earlier years as there was already a driver to help encourage more system-wide thinking of priorities. After the exit from the bailout though, those macro discussions seemed replaced by a lesser level of engagement, perhaps more like what I understand seems to have existed beforehand.

For example, I am left to wonder when was the last time the Taoiseach of Ireland, all of the key Ministers and their Secretary Generals and perhaps the advisors stepped out together

for a senior management one or two day offsite to discuss together the priorities they see facing the country? It may be interesting for you in the Inquiry to ask similar questions as you analyse what was happening or not happening when the country really found itself in a mess in 2007 and 2008.

- I arrived as the Department of Finance was being restructured into two separate departments. Maybe this also accentuated the gap. Perhaps in the past with a Department of Finance responsible for the civil service, for policy advice on broad economic direction as well as for distribution of spending among departments, this absence was less critical. Also, in a somewhat closed system or recruitment, there was always the fall back that a long time civil servant always seemed to "know who to ask" or "know someone who knows the right person to get that done" from having worked with people over the years. But in the system now set up to encourage integration of people at all levels from diverse backgrounds and even from other countries, the existence of a more formalised robust system to encourage cross-disciplinary debate, thinking and action is even more critical. Large multinational companies, with ever transient work forces have spent much time trying to perfect the ways to encourage this. Perhaps there is learning there.

- Oireachtas committees might also help by acting as a forum in which technical civil servant experts together with public representatives may discuss matters freely and publicly.

But some committees prefer interrogative styles rather than debate among equals. Also, they are often done department by department rather than involving officials from across the system relevant to a subject matter. Does the adversarial nature of some Oireachtas committees encourage the type of informed cross party political debate which might serve the country well into the future?

Why, for example, would those posing the questions not simply always provide at least their preliminary questions or areas of inquiry in advance with precision? Would that not facilitate better preparation for the discussion? We all know how much better our answers were when the lecturers gave us hints as to the exam questions in school.

This is not an exam to catch out the civil servant or department with surprise questions but should rather be a public debate of the issues to inform. What is important should not be just a soundbite to get exposure on the 6pm news or in newspapers but rather the substance of the matter. From a department's perspective, success seems to be measured by having nothing reported about the discussion at all as that suggests no problems were identified. Is this the right way to encourage good debate and highlight important issues to the public?

If I might be bold, I might suggest R5a (which was not a specific area of inquiry for me) might allow interrogation of what system of Committee operation ensures the important but often boring subjects are not squeezed out by the search for sound-bites or desire to cover the very recent topical matter.

Those still wondering what I mean by this, should look to see how much I was not questioned at my last PAC appearance on the important matters of governance I raised in my opening address, which I had distributed in advance. I had thought of it as an opportunity to focus on longer term challenges facing the department, how we were

working to be more efficient in use of resources and public money and how we had been working to address the structural issues identified in earlier reports on the Department. These are now similar questions to those before the inquiry.

If the political process and public interest value the importance of these governance issues before the problem arises, then they should also encourage time be spent to understand and debate them even if the news at 6pm will be less enthusiastic about covering them.

It is not my intention to be critical of one side or the other. Each part of the system has obvious strengths. I have hoped simply to raise aspects of the operation of the system which appeared to me at least (an outsider to the existing system) to be areas where perhaps the system operating in 2011-2014 remains based on traditions, many emanating from the establishment of the state or even older Whitehall days, which are not quite the same elsewhere. Our system might still be correct but in the aftermath of yet another major failure to protect the citizens of the country, I would suggest at least a re-evaluation of suitability is in order.

D The Department's Relationships with the NTMA and the Central Bank

(a) 2011 banking policy governance changes

My early observation to the Minister in 2011, after I moved to the Department, was that it had been complicated to move decisively and cohesively on the bank restructuring as there were essentially three different actors of Government, (i) the Minister and the Department's banking policy unit, (ii) the NTMA's shareholder management unit, and (iii) the Central Bank team supervising the banks and coming up with resolution strategies.

In early 2011, the Central Bank alone had engaged the necessary (but not inexpensive) advisors of the quality required to manage the key PCAR process but the Minister (or NPRF) was the shareholder of the banks. Additionally, the CBI was the only institution which had in earnest begun the recruitment of the necessary extra staff to handle the extent of the crisis.

Better cooperation and communication was I believe an outcome of my own move from the Central Bank team to the Department and by our decision to move the NTMA team physically and from a governance point of view into the Department. Michael Torpey, as head of that team, sat not just on the management structure of the NTMA but now equally on the Department's management team. In this way, he was able to embed key officials of the former Department's banking unit into his team and create an integrated team of both experienced corporate finance professionals and experienced civil servants to assist me and the Minister in a complex job at hand. Closer cooperation with the PCAR banks also meant finally that the investor public regained confidence that Ireland was operating to a single coherent plan of action.

Certainly, the process of tapping into the best advice for the tough decisions was made much more seamless with officials from this banking unit readily participating also in discussions around the Economic Management Council table. The experts were readily available to and directly embedded in the Department's process of advising the Minister rather than have their advice transferred from the NTMA to the Minister by other Department officials or memorandum. I would suggest that

these changes helped the better evolution of decision making about, for example, the removal of the guarantee or the restructuring of the promissory notes.

(b) Governance of the NTMA and the role of the Department

There are a number of observations I might also proffer about the way in which the NTMA had been operating in early 2011.

- The original structure set up for the NTMA seemed intended not to prioritise strong flows of two way information between the agency and the Department in ways to encourage the expression of views by Department officials on activities within the remit of the NTMA and vice versa. The CEO of the NTMA regularly reported directly to the Minister and sought permission to take various funding decisions, but most typically not in the presence of officials of the Department whose views could only be solicited often after the fact.
- Additionally, since the Department Secretary General was merely a participant on the CEO of the NTMA's *advisory council* (not a board with a binding authority as a matter of governance) the oversight role of the Secretary General and his or her role in day to day NTMA activities was also very limited.
- No one from the NTMA attended the Department's management meetings.
- The relationship *de facto* worked well but much of this could be put down to good inter personal relationships not *de jure* protections. Had that former element broken down, the structure had few of the checks and balances one might like to see to deal with a concentration of very considerable power in the role of the CEO of the NTMA. This was even more important with the expanding role being suggested with the development of New Era and the Strategic Investment Fund.

As a result, during my tenure as Secretary General and with the strong support of John Corrigan

- a new "Financing the State" unit in Merrion Street reporting directly to me and staffed by another very experienced financing practitioner (seconded to the Department from the NTMA) helped break down barriers and improve Departmental analysis, and
- very important governance changes were introduced by statute:-
  - A board appointed by the Minister would henceforth manage the NTMA and the CEO would be answerable to the board.
  - There would be a Chairman who would also be appointed by and available also to the Minister.
  - There would be a statutory position for the Secretary Generals of both the Department of Finance and the Department of Public Expenditure and Reform on the board, and *ergo* a role for both in the management of the Agency.
  - An independent investment committee would be responsible for the investment decisions of the SIF.

(c) Communications between the Department, the Central Bank and the NTMA

The Secretary General of the Department serves on the Commission of the Central Bank, a role which has caused much annoyance to the officials of the IMF when asked to opine on the required independence of the Central Bank from political interference.

In the absence of other alternatives, this bridges the discussions between the Central Bank management and those of the Department on key strategic matters. Informal discussions between

the Governor and the Minister or between officials of both institutions must not be the only channel.

At least during the crisis (I do not know the provenance of this structure), a body referred to as the Principals Group, involving key officials from the Central Bank, the NTMA and the Department also met (sometimes weekly or even more frequently) to deal especially with operational issues associated with the bank restructuring and the bailout negotiations.

The challenge was to move the agenda of this meeting away from operational issues and into the realm of financial stability of the economy, of the financial sector and of the state's funding, seen perhaps by some as areas of their own exclusive competencies. Many other countries have relied on such a tri-partite forum as a real discussion forum to test expectations of the future and the robustness of a state's responses to challenges arising from those expectations. The Inquiry may have seen the correspondence between the agencies as to changes which might be made to the operation of the committee to make it more strategic in focus and have views thereon.

E Changes made to the Department

As already mentioned, I set out in detail for the PAC measures we had taken to reform the operation of the Department in the years I was Secretary General.

I cannot improve the description by restating it in new words here. I would therefore commend the members of the Inquiry to the full text of that opening statement.

CLOSING REMARKS

By way of closing context, you might say a form of disclaimer, I would add:-

- I only joined the Department of Finance in March 2011, after many of the decisions the subject of the inquiry had been taken. I therefore had to make decisions and recommendations based on the reality of these decisions. Speculation as to what might have happened had they been otherwise was never going to be a productive use of valuable time while we were fighting the crisis;
- I was not involved at the Central Bank in any of the discussions leading up to the bailout announcement nor the negotiations on the original bailout terms;
- In helping the inquiry, I have to be conscious not just of my obligations under the Official Secrets Act 1963 Act but also the obligations of Section 33ak of the Central Bank Act, 1942;
- I have not engaged a team of people to help me reanalyse history and files in detail (which anyway are not in my possession) and therefore the above observations are based largely on recollection which I hope is not incomplete or coloured with the passage of time and subsequent events;
- I would however refer the members of the Inquiry to the more detailed Annual Reports of 2012 and 2013 published by the Department during my tenure. These present a more comprehensive description of matters I have not had the space to elaborate on here as fully as I would have liked.
- I am sure that my successor has made further refinements beyond those described and perhaps modified the approach I have set out. I understand he will be appearing separately before the Committee and my content should therefore be read accordingly.

- As I mentioned at the outset, covering 20 items in such a short submission was never likely to do justice to the importance of each of the items and I welcome the opportunity to be able to elaborate more on the 18th June.

Clarity and effectiveness of the Government and Oireachtas oversight and role

LINE OF INQUIRY: R5d

Appropriateness of the relationships between Government, the Oireachtas, the banking sector and the property sector

Meeting with the Construction Industry Federation
10 March 2009

Attendance

Andy O'Gorman, President, CIF
Tom Parlon, Director General, CIF
Matt Gallagher, Senior Vice President, CIF
Hank Fogarty, Immediate Past President, CIF
Tom Costello, Managing Director, John Sisk & Son Ltd

Dermot McCarthy, Department of the Taoiseach
Mary Doyle, Department of the Taoiseach
Philip Kelly, Department of the Taoiseach
John Shaw, Department of the Taoiseach
Sharon Finegan. Department of the Taoiseach
Dermot Nolan, Department of Finance
Breda Kenny, Department of Finance
Liam Smith, Department of Finance

Overview

The meeting was convened at the request of the CIF to provide the Government with an assessment of the construction industry at present and to outline some suggestions which the CIF has to stimulate growth and job creation. The main points of note in respect of the sector are as follows:

- The size of the industry is shrinking considerably.
- Industry continues to employ 400,000; however these jobs are at risk.
- The number of housing completions has dropped exponentially; with only 700 completions so far in 2009.
- House prices have dropped by between 40-50%

The two main proposals made by the Sector are as follows:

- To introduce a stimulus package which could potentially receive off-balance sheet funding from the pension reserve fund.
- To introduce a new tax credit scheme for first time buyers, which would make €20,000 available over 4 years.

Details

Representatives from the CIF began by giving their **assessment of the industry** and how it was being affected by the current economic crisis. The estimated value for the industry in 2010 was given as €12 billion. This is approximately one third of what it was before the economic slowdown. The industry continues to employ some 400,000 people directly, with some 100,000 in indirect employment.

DOT02B04-V
70
DOT00705-001

In relation to the **barriers to activity**, the CIF stated that there are a range of potential schemes which could be progressed but which are being delayed by An Bórd Pleanála. Any steps which could be taken to relieve these delays would be most welcome. Reference was made in particular to the construction of schools, Co-located Hospitals and Primary Healthcare Centres in this context.

A number of other points were made by the delegation as follows:

- There is no indication from businesses on the ground that the banks are behaving differently following recapitalisation. **Credit** is still not being made available and this continues to cause problems for CIF members.
- In order to garner support for the actions which the Government will need to take over the coming months it will be necessary to mobilize a **broad understanding** of the motives for Government's actions in each area. A clear narrative providing sound reasoning will be essential.

In response to the points raised by the sector Mr. McCarthy thanked the CIF for their suggestion and stated that they will be considered carefully. Any measures which are pursued must seek to credibly address the fiscal situation. If there are plausible off-balance sheet ideas which could be pursued, these must be looked at closely. In respect of the specific suggestion made around housing, he reiterated the previously expressed sentiments around the difficulties with making amendments to the housing market.

It was agreed that the CIF would provide the Department of Finance with as much information as possible relating to their proposals as a matter of urgency and that contact would continue on these issues.

Economic and Social Policy Division
11 March 2009

DOT02B04-V

DOT00705-002

(7) 12

CONSTRUCTION INDUSTRY FEDERATION

Construction House, Canal Road, Dublin 6. Tel: 01-4066000. Fax: 01-4966953. E-mail: cif@cif.ie Website: www.cif.ie

23 January, 2009

26 JAN 2009

Mr Brian Cowen, T.D.
An Taoiseach
Government Buildings
Upper Merrion Street
Dublin 2

CIF Submission to the Department of the Taoiseach on Ireland's Economic Recovery

Dear Taoiseach,

Further to my letter of the 21st January I now enclose CIF's submission that sets out the measures required to maximise the contribution of the construction sector to Ireland's economic recovery.

Addressing the problems in construction represents a most immediate and effective way of stemming job losses, boosting government revenues and improving confidence across the economy. In this regard, a number of specific government measures are required in relation to the residential and commercial property markets, public capital investment and improving our existing stock of buildings.

There is over €1.1Bn worth of VAT tied up in the estimated 35,000 unsold new homes currently on the market. This is at a time when housing affordability has improved significantly, with houses more affordable today than at any time during the past 13 years. Because of recent uncertainties and a lack of finance an estimated 30,000 house buyers have postponed their purchases but with the right package of measures many of these would come back into the market.

To facilitate this, CIF is recommending that the Government introduce a time-bound incentive package for first time house buyers. The objective must be to create a short window of opportunity that would encourage buyers and sellers to act. In addition to the immediate pay-back to the Exchequer through increased VAT revenues, this would help to find a floor for house prices and provide the basis for a recovery in the housing market.

CIF also recommends that Government take advantage of the excellent value available in the market place to help meet its social housing requirements. Specifically, CIF believes that, with market prices in many cases at or below construction cost, the Government should acquire an additional 10,000 units for social housing purposes.

President: A. O'Gorman. Director General: T. Parlon. Chief Operations Officer: G. Hennessy.
Directors: H. Fitzpatrick, R. Gilboy, E. Keenan, J. O'Brien, E. O'Neill (Secretary), D. O'Sullivan, M. Whelan.

DOT02B04-V 72 DOT00718-001

In respect of the commercial property market, the Government should bring Ireland's transaction costs into line with those of its competitor economies. Reducing the rate of commercial property stamp duty from 6% to 4% would make an immediate contribution. Given the paucity of investor activity and the huge competition in terms of investment opportunities, it is clearly counter-productive to price Ireland out of the market through higher transaction costs.

Addressing Ireland's infrastructure deficits must be a priority both in terms of providing for the longer term competitiveness of the economy and to immediately provide for economic activity, jobs and increased government revenues.

In the first instance Government must reinstate all projects cancelled or deferred as a result of the Budget cut backs in capital spending. Ireland is uniquely positioned in terms of having a list of projects that are ready to go or at a very advanced stage of planning, yet we have chosen to delay or cancel these projects at a time when their construction would make a huge contribution to employment and to overall economic activity.

Projects are ready to go across all public infrastructure headings, including:

- Roads (e.g. Newlands Cross Upgrade; N18 Gort to Oranmore, N5 Longford Bypass, Tuam and Claregalway Bypasses, M17 Rathmorrissey to Tuam, N25 Carrigtwohill to Middleton)
- Public Transportation (e.g. Luas, Metro)
- Education (e.g. schools building programme, Grangegorman)
- Health (e.g. primary healthcare facilities, HSE hospital building programme)
- Environment (e.g. social housing, rollout of waster and waste water improvement schemes)
- Justice (courts, garda stations, prisons)
- Sports and Leisure (e.g. Sports Campus Ireland)

In relation to many of the above projects, contractors and the State have already invested significantly on site acquisition, design and other bid costs.

Other economies are attempting to put in place economic recovery plans based on infrastructure development but are nowhere near Ireland in terms of having a list of projects that can be commenced immediately.

In addition, CIF recommends additional Government investment in the country's network of national primary and secondary roads that are included in Tranport 21 but have yet to be started, and new additional investment in labour intensive school, social housing and primary health care building projects. The Construction Industry Council (CIC) has presented Government with a range of policy options including off balance sheet financing models which could be used to leverage additional private sector investment in these areas.

The attached document outlines the significant return to the State from its investment in infrastructure.

The CIF also recommends the introduction of enhanced Government incentives for homeowners to improve the energy efficiency of their homes. Over 900,000 houses, half of our existing housing stock, were built prior to 1990, when the first building regulations were introduced. Retrofitting these houses to improve their energy efficiency would create a substantial new industry and achieve significant reductions in energy costs for home owners and savings for the State under Kyoto.

CIF's position on pay is clearly set out in the attached document. CIF believes that it is imperative that pay rates are cut by at least 10% to help safeguard jobs in the industry and protect small and medium companies that are located throughout the country.

The attached document also sets out the need for a co-ordinated approach from State agencies such as FAS along with the Department of Enterprise, Trade and Employment in terms of providing for the industry's ongoing training and up skilling requirements.

The range of measures outlined above and in greater detail in our attached document, coupled with decisive direction from Government in relation to current expenditure, would make an immediate contribution to economic recovery and help Ireland meet the competitiveness challenges that threaten the economy in the medium and long term.

Yours sincerely,

TOM PARLON
DIRECTOR GENERAL

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File Number: S255/10/10/0001I √Checked CL ✓ MS

File Name Representations to the Taoiseach, 26th January 2009 - 27th January 2009

Index &
26 JAN 2009

26 January 2009

Mr. Tom Parlon
Director General
Construction Industry Federation
Construction House
Canal Road
Dublin 6

Dear Mr. Parlon,

I wish to acknowledge receipt of your letter and enclosure of 23 January, 2009 which will be brought to the Taoiseach's attention as soon as possible.

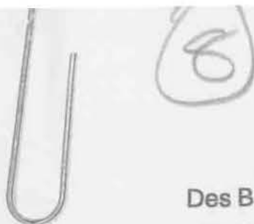
Yours sincerely,
Paul Mooney

Paul Mooney
Taoiseach's Private Office

Mr. Joe Lennon
Mr. Peter Clinch

For information

Telephone: 01-6194020
E-mail: privateoffice@taoiseach.gov.ie



13

Des Burns/LIB/DOT	To	privateoffice@dot
11/02/2009 18:42	cc	
	bcc	
	Subject	TO EACH MEMBER OF THE OIREACHTAS

----- Forwarded by Des Burns/LIB/DOT on 11/02/2009 18:42 -----

"Sinead Cashin" <scashin@cif.ie>	To	"Martin Whelan" <mwhelan@cif.ie>
09/02/2009 15:35	cc	
	Subject	TO EACH MEMBER OF THE OIREACHTAS

9th February 2009

TO EACH MEMBER OF THE OIREACHTAS

Please find attached data setting out the number of construction job losses throughout the country, broken down by region, over the past two years and projections of further job losses in 2009.

Based on current trends, construction jobs are being lost at a monthly rate of over 7,000.

CIF has made a number of policy recommendations to Government related to infrastructure development planning. The measures suggested would help to stem job losses in the sector, increase Government revenues and promote greater confidence and activity in the wider economy.

One of CIF's recommendations relates to the retrofitting of existing homes to improve their energy efficiency. Over 900,000 houses, or half Ireland's entire housing stock, were built before 1990 when the first Building Regulations were introduced. Sustainable Energy Ireland's (SEI) analysis indicates that these houses are energy inefficient – this has implications on an individual basis in terms of annual energy (heating and electricity) bills and for the economy and environment in terms of CO_2 emissions.

Measures aimed at improving the energy efficiency of these homes have the potential to more than halve annual household energy bills and help Ireland meet it's Kyoto commitments and at the same time, save the Exchequer

reducing our reliance on carbon credits. In this regard, the National Insulation Scheme announced yesterday is a very welcome boost. It is welcome because international experience shows us that some form of Government stimuli is required to generate sufficient activity in this area to create critical mass.

It is likely however that this scheme will become quickly oversubscribed. It is also the case that there is huge potential in terms of extending supports such as these to our public and commercial building stock.

As a public representative, I would ask you to support the range of initiatives in this area and to encourage the Government to expand the supports available in order to unlock the economic and environmental potential from this sector.

To understand the possible economic return to the State it is worth noting that every €100m of expenditure on retrofitting homes generates a return of €52.5m to the State (€13.5m VAT, €14m Income Tax, €25m on Social Welfare Savings). Additional sources of Exchequer receipts such as Corporation Tax and Carbon Credit Savings are not included. The Government's investment of €100m is likely to stimulate a further €400m worth of expenditure, meaning that the return to the State from the initial outlay of €100m will be of the order of €260m. In total, the home retrofit market represents a potential €9bn sector and perhaps that again if our public buildings (including schools and hospitals) were included.

I will be writing to you in the coming weeks to outline our proposals on infrastructure spending more generally. Since the October Budget the amount of committed spending on infrastructure has been reduced significantly and the pipeline of new infrastructure projects is frozen. I will provide you with our detailed analysis in this area and to outline our proposals.

I appreciate your consideration of the above and am available to discuss these or any other matters in more detail at your convenience.

Yours sincerely,

Martin Whelan

Director of Communications

01 4066000

086 8568151

mwhelan@cif.ie

Construction Industry Federation

Construction House

Canal Road

Dublin6

www.cif.ie

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This email, its contents and any files attached are a confidential communication and are intended only for the named addressees indicated in the message. If you are not the named addressee or if you have received this email in error, (a) you may not, without the consent of CIF, copy, use or rely on any information or attachments in any way and (b) please notify the sender by return email and delete it from your email system. Unless separately agreed, CIF does not accept any responsibility for the accuracy or completeness of the contents of this email or its attachments. Please note that any views, opinion or advice contained in this communication are those of the sending individual and not those of CIF and CIF shall have no liability whatsoever in relation to this communication (or its content) unless separately agreed.

##

- CIF 9th Feb 2009 Oireachtas Members.pdf

Potential Employment Benefits and Return to exchequer of

- €100m retrofitting industry
- €500m retrofitting industry
- €1bn retrofitting industry

Heading		Scenario 1	Scenario 2	Scenario 3
Size of the retrofit industry		€100m	€500m	€1Bn
Cost of labour	50%	€50m	€250	€500m
Direct employment	€50,000	1,000 people	5,000 people	10,000 people
Indirect employment	40%	400 people	2000 people	4000 people
Total employment costs	€50,000	€70m	€350m	€700m
Employment tax take		€11m	€55m	€110m
Social welfare savings		€25.5m	€127.5m	€255m
VAT	13.5%	€13.5m	€67.5m	€135
Excise duty		€2m	€10m	€20m
Total Exchequer returns		€52m	€260m	€520

Construction Employment Broken down Regionally 2007 - 2010

	Border	Midlands	West	Dublin	Mid-East	Mid-West	South-East	South-West	Total
Q1 2007	33,600	20,500	31,500	60,500	33,700	25,200	32,700	44,500	282,200
Q1 2008	33,000	19,000	29,200	62,500	33,900	23,400	34,500	38,900	274,400
Q1 2009	21,997	12,093	21,728	42,658	25,615	15,715	22,724	27,675	190,205
Actual Job losses 2007 - 2009	*11,603*	*8,407*	*9,772*	*17,842*	*8,085*	*9,485*	*9,976*	*16,825*	*91,995*
Projected employment at Q1 2010	15,458	8,573	15,458	30,283	18,190	11,150	16,124	19,645	135,881
Expected job losses in 2009	*6,539*	*3,520*	*6,270*	*12,375*	*7,425*	*4,565*	*6,600*	*8,030*	*54,324*
Monthly job losses in 2008	*917*	*576*	*623*	*1,654*	*690*	*640*	*981*	*935*	*7,016*
Projected Total Job losses 2007 - 2010	*18,142*	*11,927*	*16,042*	*30,217*	*15,510*	*14,050*	*16,576*	*24,855*	*146,319*

Border - (Cavan; Donegal; Leitrim; Louth; Monaghan; Sligo)
Midlands - (Laois; Longford; Offaly; Westmeath)
West - (Galway; Mayo; Roscommon)
Dublin - (City & County)
Mid East – (Kildare; Louth; Meath)
Mid West – (Clare, Limerick, North Tipperary)
South East – (Carlow; Kilkenny; South Tipperary, Waterford; Wexford)
South West – (Cork; Kerry)

(9)

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CONSTRUCTION INDUSTRY FEDERATION

Construction House, Canal Road, Dublin 6. Tel: 01-4066000. Fax: 01-4966953. E-mail: cif@cif.ie Website: www.cif.ie

Mr Brian Cowen, T.D.
An Taoiseach
Government Buildings
Upper Merrion Street
Dublin 2

20 March, 2009

Dear Taoiseach,

Since the Government announced its €7bn recapitalisation plan of Allied Irish Bank (AIB) and Bank of Ireland (BOI) both banks have made a major public play of being "open for business", particularly in relation to mortgage lending and loans to small and medium businesses. There isn't a shred of evidence to back up these claims but there is plenty to suggest that the banks are engaged in a cynical PR exercise aimed at pulling the wool over the Government's eyes.

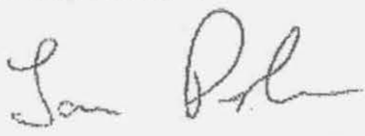
We have seen a flood of full page advertisements by AIB and BOI stating that they have a combined €2bn worth of mortgages waiting for prospective house buyers. Bank of Ireland is even offering €1,000.00 cash for anybody who draws down a mortgage. The reality is that it is virtually impossible for prospective house buyers to qualify for a sufficient mortgage to go ahead with their purchase – the banks have deliberately erected an elaborate and discouraging criteria for mortgages that very few people will be able to satisfy.

Both banks have also repeatedly professed their commitment to supporting businesses. Feedback from CIF members would suggest that the complete opposite is the case.

Both banks are raising their margins (with one introducing a 'funding premium') on existing and new credit facilities even though the funding cost to the banks have reduced significantly. And, working capital isn't available in any circumstance. One member was refused €80,000, which was needed to free up €600,000 worth of sales that would have gone straight back to the banks.

Both AIB and BOI are beholden to the Irish government and the taxpayer for their very existence, yet both are putting on a public masquerade as regards their lending credentials, and liquidity within the Irish economy is grinding to a shuddering halt.

Yours sincerely,



TOM PARLON
DIRECTOR GENERAL

President: A. O'Gorman. Director General: T. Parlon. Chief Operations Officer: G. Hennessy.
Directors: H. Fitzpatrick, R. Gilboy, E. Keenan, J. O'Brien, E. O'Neill (Secretary), D. O'Sullivan, M. Whelan.

15

Webmaster/LIB/DOT
24/03/2009 14:18

To privateoffice@dot
cc
bcc
Subject Fw: Email from Tom Parlon, Director General Construction Industry Federation (CIF) Re April 7th Mini Budget

----- Forwarded by Webmaster/LIB/DOT on 24/03/2009 14:18 -----

"Cathal Lee" <clee@cif.ie>
24/03/2009 11:32

To "Cathal Lee" <clee@cif.ie>
cc
Subject Email from Tom Parlon, Director General Construction Industry Federation (CIF) Re April 7th Mini Budget

To all members of the Cabinet

Please note that a letter version of the email (Re April 7th Mini Budget) has also been sent to your office.

The letter will also contain details of the "Stimulus Package for Generation of Housing Transactions 2009"

Yours sincerely,

Tom Parlon

Director General

Construction Industry Federation (CIF)

01 4066000

15

Webmaster/LIB/DOT
24/03/2009 14:18

To privateoffice@dot
cc
bcc
Subject Fw: April 7th Mini Budget

----- Forwarded by Webmaster/LIB/DOT on 24/03/2009 14:18 -----

"Cathal Lee" <clee@cif.ie>
24/03/2009 12:11

To <taoiseach@taoiseach.gov.ie>
cc
Subject Re: April 7th Mini Budget

An Taoiseach Brian Cowen T.D

Department of An Taoiseach

Upper Merrion Street,

Dublin2.

Dear Taoiseach

Re: April 7th Mini Budget

Following an emergency meeting of the major construction employers on Monday 9th March, a delegation of CIF members met with a number of your party colleagues to appraise them of the industry's potential to generate jobs and increased government revenues in the event of specific budgetary measures in relation to capital spending and the housing market. I have been asked to bring these proposals to your direct attention.

At the outset, I would like to state clearly the CIF's recognition of the huge and complex challenges facing the government in the Budget on 7th April. Clearly the primary focus will be on steadying the public finances given the widening gap between revenues and spending. However, in light of the fact that 1,000 people are losing their job every day and recent CSO figures showing a complete collapse in spending across the economy, any package of tax increases and spending cuts must be balanced with measures that generate increased economic activity. The construction industry, the most labour intensive sector of the economy, is the best

positioned sector of the economy to generate an immediate return on investment to the Exchequer.

In terms of budgetary savings, the priority must be on reining in day-to-day spending, which no longer bears any relationship with what is happening in the wider Irish economy. Ireland's own recent economic history clearly demonstrates that focusing on tax-raising instead of on current expenditure is self defeating.

Clearly also, the Budget must attempt to stabilise the banking system. Despite efforts to date, a lack of finance remains the primary reason for the delay/postponement of projects in the private sector, which is forecast to decline further, and the inability of consumers, including prospective house buyers, to proceed with intended purchases. There will be no pick up on the private side of the economy until the government can ensure lending to prudent borrowers (business and consumer).

In terms of generating activity, there is a real opportunity to save jobs and boost the Exchequer at the same time as developing new and badly needed infrastructure at excellent value for money for the economy. This requires, however, a reversal of the recent policy of cutting capital spending.

In last October's Budget and again in February, the government significantly cut the capital investment programme with very serious consequences for construction employment and wider economic activity.

The current capital budget for 2009 is more than €1bn less than originally planned.

Projects that, on paper, are to proceed are instead being delayed/deferred/cancelled.

In areas, such as the water improvement programme, where the government announced increased spending the level of actual activity has fallen.

The effect of this approach is the decimation of employment in the industry, currently at a rate of 7,000 per month, and the loss of the skills and experience that have built up over the last decade and which will take considerable time to build up again.

It is also worrying that, increasingly, government comment on infrastructure spending has been permeated by reference to re-prioritisation, a term that many members interpret as shorthand for further cutting projects and which would have serious implications for the economy in the long-term as well as the here and now. The National Competitiveness Council amongst others has stated that our infrastructure deficit places Irelandat a significant competitive disadvantage relative to other EU countries. Cutting the capital programme will damage our competitiveness even further.

Instead, the government should take advantage of the incredible value for money and abundance of skilled productive resources to address problem areas such as schools, third level educational institutions, hospitals, primary/community healthcare, roads and public transport, and water quality.

The return to the state on investment over the medium- and long-term is universally accepted. The ESRI, for instance, shows that investment in infrastructure leads to a permanent increase in GNP of the order of €0.4bn per annum for every €1bn invested (a pay back of less than 3 years to the Exchequer).

Investment also makes an even more immediate contribution to the economy. Every €100m spent on construction projects creates 1,000 jobs for a year and immediately returns nearly €50m to the exchequer through direct taxes and social welfare savings. It also generates jobs and taxes elsewhere in the economy.

The CIF also fully supports the proposals from the Construction Industry Council (CIC) that have been submitted to Government and which are aimed at supporting an additional €5bn in infrastructure investment using off balance sheet funding mechanisms.

The CIF also proposes a number of measures that would unlock the revenue potential tied up in unsold new housing stock (see Briefing Document below). The document identifies an estimated 35,000 houses that are already completed but not sold. The sale of these houses would release an estimated €1.1bn in VAT receipts to the Exchequer, and stimulate consumption, taxes and employment in other areas of the economy. In order to be effective, the measures proposed in the attached should be available for a limited time period only.

The measures outlined above have the potential to make a substantial and immediate contribution to economic recovery. I would ask that you consider the

proposals and I can forward any additional information or clarification that you may require.

Yours sincerely,

This letter has been circulated to all members of the Cabinet

Irish Auctioneers Valuers Institution (IAVI) / Construction Industry Federation (CIF) /

Irish Home Builders Association (IHBA)

Stimulus Package for Generation of Housing Transactions 2009

Summary

Residential construction activity has reached a virtual standstill. Exchequer revenues will not be restored until housing transactions start again. Government now has the opportunity to introduce measures to restore confidence and transaction activity amongst prospective ready and willing home buyers.

This CIF/IHBA proposal details two short term schemes to encourage home buyers, as well as generate much needed cash flow for government and businesses participating in the housing market, namely;

Introduce direct assistance/incentive for first time buyers of new homes, and

Introduce relief from residential Stamp Duty until end 2009.

Either scheme should apply for a very limited period of time. Such a scheme to potential purchasers should reduce in value at 31 December 2009 and expire altogether at 31 December 2010. Both schemes have the potential to generate a positive cash contribution to the Exchequer ranging from €492 to €717m for the combined years of 2009 and 2010.

The principal aim is to reduce the estimated 35,000 new houses that are already completed but not sold. If these 35,000 houses were to sell, it could release an estimated €1.1 billion in VAT receipts to the Exchequer immediately.

There clearly has to be a strong incentive for Government to restore activity in the market, as it would alleviate much of the current pressure on Exchequer revenues and spending, and economic activity in general.

-

The following option is suggested for consideration:-

<u>A) Introduce direct assistance/ incentive for first time buyers of new homes by:</u>

-

1. **Introduction of First Time Buyers Incentive Scheme; or**
2. **Allow a Tax Credit Scheme to assist purchasers**

Any initiative taken must be simple, easily understood and attractive to purchasers.

Availability of either of these initiatives must be short term. Any such scheme must have a limited life so as to make participation in the scheme attractive to the purchaser immediately.

The introduction of a scheme of the nature suggested will not drive up house prices. It will present a situation whereby the existing stock of unsold new homes may start to move again, generating transactions for the wider economy.

1. First Time Buyers Incentive Scheme

In the case of a First Time Buyer's Incentive Scheme, it is suggested that the level of incentive should be set at €20,000 for period up to 31 December 2009, and €10,000 euro for the period 1 January 2010 to 31 December 2010. Payment of the incentive would be dependent on contract signing for purchase of new home prior to relevant dates, i.e. 31 December 2009 or 31 December 2010.

1. Tax Credit Scheme

In the case of a Tax Credit Scheme, the proposal could be to grant a tax credit of €5,000 per annum for a period of 4 years to a first time buyer who purchases a new home up to 125m^2 in size, provided the transaction is committed to prior to 31st December 2009. For those who purchase between 1 January 2010 and 31 December 2010, the tax credit could amount to €5,000 per annum for a period of two years. It is possible the tax-credit could be paid directly to the lender over the 4 or 2 year period using the same basis upon which mortgage interest relief is paid directly to banks. The Revenue Commissioners would provide the lender with a letter confirming the tax credit over the relevant period. The builder/developer could also play his part by accepting responsibility for any interest charges that may be imposed by the lender in advancing the gross value of the tax credit to the purchaser.

Implementation of this suggested scheme will result in a slow payout of benefits by the Exchequer with an immediate cash return to the Exchequer in respect of VAT due on transactions completed.

See attached appendices outlining net cash flow benefit to government arising from implementation of either of the measures outlined above. The net benefit to the Exchequer from implementation of a First Time Buyers Incentive Scheme for 2009 could be €171m, while for 2010, net benefit could be €321m.

Under the Tax Credit Scheme, net cash flow benefit to the Exchequer will be €396m for 2009 and €321m for 2010, while net cost will be €150m for 2011 and €75m for 2012.

Introduction of schemes of this nature will bring about a greater level of certainty which will stimulate the overall economy and generate activity in a wide range of services. This will facilitate retention of employment and retention of government tax revenues.

It is important that lenders stress test borrowers with no allowance for whichever of these provisions is to be made available, so as to prevent increased borrowing resulting.

B) Relief from residential Stamp Duty until end 2009

In the case of residential stamp duty, the proposal is to offer relief from stamp duty until the end of 2009 which would help ignite sales in the second-hand housing market. At present, for example, residential stamp duty acts as a huge impediment to those wishing to downsize. Temporary relief from stamp duty has the potential to increase transactions across the market in both new and second-hand houses. Furthermore, stamp duty on residential property should be reviewed having regard to the BER applicable to the property and in light of the forthcoming report to be published by the Commission on Taxation. By attaching a lower rate of stamp duty to a higher building energy rating, homeowners would potentially be stimulated to retrofit the house in order to attract more buyers. This proposal reflects current policy in line with the polluter pays principle.

Impact of Increased Sales of 30,000 Houses

-

If, following the implementation of above initiatives, 30,000 sales of new homes out of the existing stock of unsold new housing were to materialise:-

- It is estimated that for a new home, the average outlay to make it habitable in terms of furniture and fittings is around €6,000. The extra sales would generate increased retail spending of €180 million, resulting in VAT receipts of €38.7 million;
- Based on the average house price, the sales of 30,000 unsold new houses that are already built, would release €942.1 million in VAT receipts on sales of new houses;
- Conveyancing and estate agent costs typically were charged at 2% of purchase price, but this has come down in the tighter housing market environment that has evolved over the past year. If we assume an average conveyancing cost of €1,500 + VAT@21.5%, the sale of 30,000 extra homes would generate conveyancing fees alone of €45 million and increased VAT receipts of €9.67 million;
- On the basis of development levies of €10,000 per home being payable, this will yield an additional €300 million for local authorities to fund their infrastructural programmes.

The increased tax take as a result of an increase in 30,000 new home sales could yield up to €1.29bn to the Exchequer.

It is clear that generating transactional activity will increase sales and generate considerable revenues for Government in terms of VAT receipts on new unsold housing, the VAT content of increased retail sales to fit out the new house and increased employment in retail, legal and real estate services, and increased corporation tax payments, and possibly CGT payments.

Generating sales of existing stock will also create an environment whereby some building activity could start again in key growth areas. The increase in employment would also reduce the burden of social welfare payments were the increased employment to reduce the numbers signing on the live register.

Appendix 1: First Time Buyers Incentive Scheme: Net benefit to Exchequer (on VAT receipts alone)

	2009	**2010**
	Average National House Price	**Average National House Price**
Average House Price	264,026	264,026

Average VAT (at 13.5%) **due to the Exchequer on closing of sale**	31,404	31,404
Assumption: 15,000 First Time Buyers home sales both in 2009 and 2010 **- with incentive from government**		
	2009	**2010**
Estimated number of sales	15,000	15,000
Cash Flow Benefit to Exchequer arising from First Time Buyers Incentive Scheme		
	2009	**2010**
	[€31,404 X 15,000]	[[€31,404X 15,000]
Total VAT element of sales payable to the Exchequer	**€471 million**	**€471 million**

	[€20,000 x 15,000]	[€10,000 x 15,000]
Cost of scheme to the Exchequer	€300 million	€150 million
Net Benefit to Exchequer	€171 million	€321 million
Net Benefit 2009-2010	€492 million	

Appendix 2: Tax Credit System: Net Benefit to Exchequer

Action:

- tax credit of €5,000 per annum for a period of 4 years to a First Time Buyer who buys a new home up to 125m² where the transaction is completed on of before 31st December 2009.
- for any FTB who purchases in 2010, the tax credit of €5,000 per annum would be payable over a reduced period of two years only.
- tax credit to be payable directly to lender during respective period

	2009	2010	2011	2012
1st Assumption: 15,000 First Time Buyers avail of 4 year tax credit option and purchase new home up to 125m² during 2009	€75m	€75m	€75m	€75m

Total VAT payable to the Exchequer following purchase of 15,000 new housing units at current national average house price of €264,026	€471m			
Less total cost of tax credit during year 1	€75m			
Net Benefit of tax credit scheme in 2009	€396m			

	2009	2010	2011	2012
2nd Assumption: 15,000 First Time Buyers avail of 2 year tax credit option and purchase new home up to 125m² during 2010		€75m	€75m	
Total VAT payable to the Exchequer following purchase of 15,000 new housing units at current national average house price of €264,026		€471m		
Less total cost of tax credit during year 2		€75m		

Net Benefit of tax credit scheme in 2010		**€321m**		
Combined Total Net Benefit to the Exchequer in 2009 and 2010	**€717m**			

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Ackknowledge and Refer Email Details

Index & P.A.
25 MAR 2009

File Number: S255/10/10/0002

File Name Representations to the Taoiseach 20th March - 25th March 2009

email issued on	25/03/2009
email received from	Tom Parlon Director Construction Industry Federation clee@cif.ie
Details of Material	email sent from Mr. Cathal Lee from Mr. Tom Parlon re April 7th Budget. Hard copy of this correspondence will follow.
email sent to	clee@cif.ie
Subject of email:	email to the Taoiseach
Text of email	Dear Mr. Parlon I wish to acknowledge receipt of your email of 24 March, 2009 which will be brought to the Taoiseach's attention as soon as possible. Yours sincerely, DAVID KING David King Assistant Private Secretary to the Taoiseach Telephone: 01-6194020 E-mail: privateoffice@taoiseach.gov.ie

Dermot McCarthy/Joe Lennon/Peter Clinch
For information

History: - Email Ack & Refer Issued to clee@cif.ie (Niamh O'Brien - 25/03/2009)

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19 NOV. 2009

Irish Concrete Federation

8 Newlands Business Park, Naas Road, Clondalkin, Dublin 22 Tel: 01 464 0082 Fax: 01 464 0087
E-mail: info@irishconcrete.ie Web: www.irishconcrete.ie

17th November 2009

Mr Brian Cowen TD
Taoiseach
Dept. of an Taoiseach
Government Buildings
Upper Merrion Street
Dublin 2

Dear Taoiseach

The Irish Concrete Federation is the national representative organisation for the aggregate and concrete manufacturing industry in Ireland.

In 2007 the industry employed approximately 12,000 people in large and small businesses around Ireland. The industry is a local employer due to the nature of the business and many of the companies involved in our industry are deeply rooted in their localities providing steady employment in both urban and rural Ireland over many years.

A survey of members in early November would indicate that approximately 6,000 employees in our industry have been made redundant and in addition many of those remaining are on reduced working hours. This is as a result of the reduced demand for concrete products from the construction industry which is obviously suffering greatly in the current recession.

As you are aware, the current downturn in the country's economy can be attributed to a large number of factors, of which an over-reliance on construction, and in particular housing, was undoubtedly one. However Government has clearly articulated that addressing Ireland's competitiveness is key to tackling the current crisis. The National Competitiveness Council has stated that, despite major improvements, substantial infrastructural deficits remain. Consequently, the ICF strongly urges Government to maintain its expenditure in national infrastructure in 2010, not only to protect against further employment loss in our own industry, but also to enhance national competitiveness and assist national recovery.

I attach a brief submission on behalf of the members of our association and would welcome an opportunity to discuss any points arising from the submission with you.

We wish you well in your ongoing deliberations on Budget 2010.

Yours sincerely

Gerry Farrell

Gerry Farrell
Chief Executive

Concrete Built is Better Built

President: Christy Loughnane, **Vice-President:** Frank Byrne, **Chief Executive:** Gerry Farrell
Irish Concrete Federation Ltd: Registered in Ireland. No. 236008
Directors: A. Haugh, C. Loughnane, J.J. McGrath, M. Guinan, P. Gleeson, B. O'Reilly, F. Byrne, F. O'Neill. **Company Secretary:** J. Maguire

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Save Jobs, Improve Competitiveness - Invest in Infrastructure,

A Pre- Budget Submission by Irish Concrete Federation Members to Public Representatives – November 2009

Irish Concrete Federation

The Irish Concrete Federation is the national representative organisation for the aggregates and concrete manufacturing industry. The organisation has 90 members operating in over 200 locations throughout Ireland.

Concrete Industry Importance

The members of the Irish Concrete Federation are responsible for manufacturing the majority of aggregate, readymix concrete and precast concrete products for supply to the Irish construction industry.

Concrete is the most important building material produced for supply into the construction industry and is used in every house, school, hospital, office block, agricultural building, commercial unit and factory constructed in Ireland. In addition aggregate and concrete products are used in the construction of our road network, our public transport system and our water treatment and sewerage systems.

At its peak in 2007, output from the Irish aggregates and concrete products industry is estimated at approximately €2.5bn.

Employment in the industry is estimated at 12,000 people in 2007.

Regional Importance

As concrete is a perishable product with delivery distances rarely exceeding 35km, investment in our industry is based on supplying the local economy. *The concrete industry is a local employer,* based both in the urban centres and in rural areas where alternative industry employment is

(e) state of the art third level institutions;
(f) high quality hospital building stock;
(g) energy infrastructure

All of the investment outlined above would assist in improving Ireland's infrastructural deficit thereby increasing its attractiveness as a location for foreign direct investment and develop the productive capacity of the economy while simultaneously protecting jobs in construction and related industries.

The federation supports the proposal made in March 2009 by the Construction Industry Council (CIC) for private investment to be harnessed to invest in critical infrastructure. The CIC proposed that an investment of €5bn in public infrastructure could save 70,000 jobs with a substantial portion of the cost financed from private sources.

Value for Money

The ICF would point to statistics produced by the Society of Chartered Surveyors that tender prices for construction projects are now at rates 25% below peak levels and are back to levels last seen in 1999.

Future Outlook

The ICF is concerned that the levels of expenditure in capital infrastructure outlined in the budget of April 2009 will result in a further contraction in the industry in 2010 and 2011. Following recent discussions with the National Roads Authority, the ICF is concerned that the national road programme will come to a virtual standstill in the second half of 2009. This will lead to further job losses in construction and related industries including concrete manufacturing. ICF calls on Government and all public representatives to support a comprehensive public capital programme to achieve the double objective of protect jobs and assist national recovery.

Summary

- The concrete industry provides stable regional employment throughout the entire country.
- 6,000 jobs have been lost in the concrete industry.
- Ireland continues to have an infrastructural deficit.
- The cost of construction projects are now back to 1999 levels
- Investing in critical public infrastructure will enhance competitiveness, assist recovery AND protect jobs.

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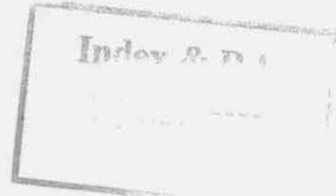
File Number: S255/10/10/0005N

File Name Representations to the Taoiseach - 18th November 2009 - 18th November 2009



19 November 2009

Mr. Gerry Farrell
Chief Executive
Irish Concrete Federation
8 Newlands Business Park
Naas Road
Clondalkin
Dublin 22

Dear Mr. Farrell,

I wish to acknowledge receipt of your letter of 17 November, 2009 which will be brought to the Taoiseach's attention as soon as possible.

DAVID KING
Yours sincerely,

David King
Assistant Private Secretary
to the Taoiseach

Mr. Joe Lennon
Mr. Peter Clinch
Mr. John Shaw

Referred please for information