"Reduction in the Public Capital Programme"
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Tom Ferris looks at the cuts made in the Public Capital Programme as part of Budget 2010. He argues that many of the cuts are justified, but in other cases, public investment should be increased. He also looks at the funding implications of public investment, and the role expected for the new National Solidarity Bond[1]

Reducing Investment

There is no doubt that the Government faces major problems in delivering on its investment commitments in these difficult economic times. Of course, the Public Capital Programme has had to suffer reductions. However, the scale of the reduction is greater than had been forecast in January 2009, in the *Addendum to the Irish Stability Programme Update.* This can be seen from a comparison of the capital forecasts published last January, and those setout in Budget 2010, last December. The comparisons are presented in the Table below.

Comparisons of Gross Voted Capital (in € millions)

	2010	2011	2012	2013	Total 2010/2013
A: 9th December 2009*	6455	5500	5500	5500	22955
B: 9th January 2009**	8297	8193	9672	9160	35322
C: A - B	-1842	-2693	-4172	-3660	-12367
D: C/B*100	-28.54%	-32.87%	-43.13%	-39.96%	-35.01%

* *Budget 2010*, **Page C 20, Department of Finance**

** ***Addendum to the Irish Stability Programme Update*, Page 8, Department of Finance**

The table shows that the Budget 2010 forecasts a reduction of 29 per cent, for the year 2010, by comparison with the January 2009 forecast. However, the scale of reduction for the following three years, 2011 through 2013, averages 39 per cent. In overall terms, the reduction is over €12 billion in the four-year period 2010 through 2013, or 35 per cent in total.

Put another way, last January's *Stability Programme* noted that investment in capital projects had been of the order of 5 per cent of GNP. However, the updated programme, published by the Department of Finance on 9 December 2009, now acknowledges that capital expenditure is forecast to average approximately 4 per cent of GNP over the period 2009-2014.

Different Pattern of Capital Cuts

The cuts in public investment vary according to Government Department. The two biggest capital spenders – the Department of Transport and the Department of Environment, Heritage and Local Government - suffered the biggest cuts in capital allocation, under Budget 2010. These two Departments taken together are responsible for over half of total capital expenditure. Each suffered a reduction in investment allocation of around €300,000 million, under Budget 2010.

Specifically, the Department of Transport's investment allocation has been cut from €2.4 billion (2009) to €2.1 billion (2010). And within transport, the impact is greatest in the area of national roads, where the 2010 capital provision is down to €1.1 billion, €287 million (or 20

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%) down on 2009. By comparison, public transport investment only suffered a slight reduction. As the Minister for Transport, Noel Dempsey, pointed out – "*The capital provision for public transport investment in 2010 is €625 million, €3 million lower than in 2009. This will see the completion of a number of important projects as follows: Western Rail Corridor Phase 1; Luas extension to Cherrywood; Kildare Rail Project and Navan Rail Line Phase 1*". He went on to point out that – "*Work will continue on the Luas extension to Citywest for completion in 2011 (and) in keeping with the commitment in the Renewed Programme for Government, priority is being given to the delivery of Metro North and DART Underground Programme*".

The Department of Environment, Heritage and Local Government has the second largest capital spending envelope (€1.5 billion) of all Departments and that is mainly directed towards supporting key investment in the provision of housing and water services infrastructure. While the 2010 capital allocation represents a cut of over €301,000 million, the Minister for Environment, Heritage and Local Government, John Gormley has pointed-out that – " *… reductions in tender prices, combined with other initiatives, will enable the Department to maintain its work in key areas of protecting the environment and promoting a sustainable society and economy".*

Two other Government Departments have suffered cuts of over €100 million. They are the Department of Education and Science (a cut of €132 million) and the Department of Agriculture, Fisheries and Food (a cut of €116 million). A range of other Government Departments have also had their allocations cut, but not as significantly as the cuts in the Government Departments already referred to. Finally, there are two Departments that got an increase in their allocations –they are the Department of Communications, Energy and Natural Resources (up by €58 million) and the Department of Justice (up by €6 million).

Capital Review

The cuts in investment were not made in a vacuum. The *Stability Programme*, recently published by the Department of Finance refers to a review of the capital programme it carried out in advance of Budget 2010, which was designed to ensure that the investment programme focused on the priorities that are most appropriate to the challenges now being faced and which promote economic recovery. That review informed the Government's decisions on capital allocations for 2010 and subsequent years. The point is made in the review that reductions in tender prices mean it is now possible to deliver capital projects more cheaply, enabling many of the goals of the National Development Plan (NDP) to be more readily achieved. As regards priorities, the Minister for Finance, Brian Lenihan, pointed out that investment projects will focus in 2010 on labour-intensive areas such as schools building and maintenance, energy efficiency measures and investment in our tourism infrastructure. As regards other key investment priorities, the Minister said that they will include science, technology and innovation; promotion of environmental sustainability; implementation of green enterprise initiatives; housing and urban regeneration; the health sector; public transport and finishing the inter-urban motorways.

Overall, there is no doubt that there should be a reduction in the provision of some projects in the NDP, as some projects are delayed reflecting a reduction in urgency as a consequence of the downturn in the economy. Moreover, there should be substantial savings in the cost of the NDP due to the falling price of projects through lower land prices, lower tender prices and lower professional fees. But the question does arise – what about projects where a legitimate case can be made for earlier start-ups, because costs will be lower than originally forecast and where a strong economic case can be produced?

A case in point is in the energy area. Evidence of this is set-out in the latest ESRI Quarterly Economic Commentary, where Professor John FitzGerald and others argued that that the level of investment needed in the electricity sector in the near future is extremely large when one considers the joint effect of building more wind-farms and the need to extend and upgrade transmission and distribution lines. They conclude that - "*Transmission and distribution need*

to be upgraded because many lines are ageing and more lines are needed to accommodate the increase in wind generation and the complementary investment in new interconnection".

Funding Investment

The funding of public investment is the really serious challenge for the Exchequer, given that public investment is virtually totally funded from borrowings. There are, however, new ways now being explored to provide funding. Two examples are relevant - one specific and one general. First, the specific funding initiative relates to the health sector. In Budget 2010, the Minister for Finance has provided for a multi-annual investment programme in mental health projects (which are in line with the strategy set out in "A Vision for Change"); he has announced that such investment would be funded from the sale of surplus HSE assets.

Second, the Government's intention to introduce a National Solidarity Bond aimed at small investors. The Minister for Finance as part of Budget 2010 announced the advent of the new bond. The National Treasury Management Agency and the Department of Finance are currently working on the details of the Bond and it is expected it will be open for investment in the near future. It should be noted that the Irish Congress of Trade Unions first called for the introduction of such a bond last January. It was then described as a National Recovery Bond. At that stage, the Congress called for the establishment of a bond which members of the public could contribute to, as part of a new Social Solidarity Pact to be drawn up in response to the economic crisis. While the pact was not agreed, the bond is to be introduced. However, there is one fundamental difference, in its proposed form of implementation, and that is that Congress saw this new stream of funding as a stimulus for new investment in public projects. The Government, on the other hand, has now made it very clear that the bond is an alternative source of funding not an additional source of funding. Specifically, it is stated that in Budget 2010 that – "…*the bond will not be used to fund additional spending*". The Construction Industry Federation (CIF), in its response to Budget 2010, wish to debate this point, as to whether the bond is a substitute form of finance, or a new source of finance for additional public sector projects. As Tom Parlon, CIF Director General, put it – "*The CIF looks forward to discussing the details of the Bond as an addition to the Public Capital Programme with the Minister*".

Investment Challenge

The Government has a difficult task in getting the scale of investment right. This is particularly true when the long lead-time in planning for public investment projects is taken into account. This is a phenomenon that has been noted recently by the International Monetary Fund (IMF). In last December's Edition of IMF's Finance and Development the conclusion is drawn that - "…*implementing capital projects generally takes longer than directly injecting demand through government purchases of goods and services*". Of course, any new public sector project should only be given the 'green-light' after it has successfully met the investment guidelines laid-down by the Department of Finance. Any new project should be delivered at the least possible cost, and that maximum output should be generated from the resources used – financial, human and physical. Moreover, there must be assurance that delivery is being achieved through proper information, analysis and audit, supported by robust systems of accountability.

In conclusion, if Ireland is to gain from the up-turn in the world economy, it needs to be planning now for many of the public sector projects required to service Ireland as a small open trading economy. There is a risk that insufficient public infrastructure will be available for an economic up-turn in the economy. This is a fear that is being addressed in the United Kingdom, where some leading firms are partnering top academic institutions to develop projects that will overhaul household energy, water, transport and waste provision to drastically cut carbon emissions –see www.instituteforsustainability.co.uk . Ireland also needs to have a sufficient infrastructure to support an economy that will be able to compete successfully in global markets, while meeting increased environmental challenges.

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