

Address by the Tanaiste and Minister for Finance to the Insurance Institute of Ireland Industry Leaders Summit 2007, on Thursday 4 October 2007 at the Four Seasons Hotel

I am delighted to have been invited to speak at your conference today. I would like to thank in particular the President of the Insurance Institute of Ireland, Mr Aidan Cassells, and the Chief Executive, Mr Denis Hevey for their invitation. The Institute have asked me to speak principally about the economy and I propose therefore to give you my perspective on how things stand at the moment, and what we need to do in order to ensure a continuation of economic growth. I will also say a few words about such issues as the International Financial Markets, the role of the insurance industry and pensions.

Economic Outlook

At the outset, I would like to say that I am confident that our economy is in good shape, however like everything else in life, I believe complacency is dangerous and we need to be conscious of developing trends so we can take the necessary measures to deal with any emerging problems. In this respect, another year of strong economic growth was recorded last year, with GNP expanding by 6.5 %. While the economy has performed well in the year so far, with GNP rising by 5.7% in the first half of the year, the indications are that the short- to medium-term outlook has deteriorated somewhat. This mainly reflects prospective developments in the new housing market, where available indicators provide clear evidence that output levels peaked last year. This moderation in new housing output will exert a drag on overall growth rates as completions revert to more sustainable levels of around 60,000 – 70,000 units per annum.

It is important that we put these likely trends into context. Firstly, this is still a very high level of output. Secondly, we are approaching this sectoral issue from a position of overall strength – unemployment is low and the public finances are in a healthy position. Finally, infrastructural spending under the National Development Plan will help to absorb some of the slack emerging as a result of lower housing output.

As residential construction activity moderates, the challenge will be to find alternative sources of growth to drive the economy forward. For a small trading nation such as Ireland, a stronger export performance will be a key determinant of future improvements in living standards. This highlights the importance of improving the economy's international cost competitiveness.

There are a number of aspects to this. Wage developments must be more closely aligned to productivity gains, while a more sustainable evolution of profits is needed. For its part, the Government will continue to implement a prudent fiscal policy. In this context, it is essential that public expectations adapt to the emerging, more sustainable growth in available resources. The Government will also continue to prioritise spending on those areas critical to long-term competitiveness and living standards, especially to investment under the National Development Plan. This investment – in infrastructure, education, science and innovation – is designed to equip Ireland to meet the challenge of a rapidly changing global economy.

Inflation is, obviously, another cause for concern for all of us at the moment. The rate of CPI inflation was 4.0 per cent last year and is currently running at 5.0 per cent so far this year. The associated rise in the cost of living is worrying but we need to look beyond the headline number and determine the causes of inflation in Ireland and how we can all work together to ease inflationary pressures. Most of the increase in the rate of inflation has been due to external factors, mainly higher interest rates due to increases by the European Central Bank. As the setting of interest rate policy is outside of our control we should concentrate on factors that we can influence. On an EU harmonised basis – which excludes the impact of interest rate changes – inflation is expected to be around 2¾ per cent this year. While this is still above the euro area average, it is expected to ease next year.

The government, along with the social partners, is taking action to address the rise in inflation. An Anti-inflation group has been re-established under the auspices of “*Towards 2016*”. This group is working on ways to combat inflation and allows government, unions and business an equal voice in the discussions. For my part, I have underlined my commitment to tackle inflation by not raising indirect taxes in each of my last three budgets. Except, of course, for tobacco products in Budget 2007 which I felt was the right thing to do for health reasons.

Service sector inflation, which is a significant contributor to our overall rate of inflation, is largely driven by demand within our own country. As well as obviously being unwelcome in itself, we need to be aware that if relatively high inflation continues here it could do irreparable damage to our international competitiveness. While, some of the levers controlling our inflation are outside of our reach, there are some that we can still use, including the wages we pay ourselves. We all have to be realistic in our expectations and acknowledge that wages should at most rise in line with productivity and that continuing to reward ourselves with pay increases above the rise in the level of productivity only serves to do long term damage to our competitiveness and so to our economy. If we do not take account of such factors, then we are unlikely to be in a sufficiently strong position in the future to continue to grow our international financial services industry. I would now like to briefly touch upon the recent difficulties in the financial markets.

International Financial Markets

Turning to recent developments in the international financial markets, I believe that the underlying strength of the global economy will be an important factor in restoring confidence among investors and in financial markets. In this respect, I note the very positive assessment contained in the IMF report of the Irish financial system. In particular, it describes the banking system in Ireland as well capitalised, profitable and

liquid. It also noted that the Central Bank is satisfied that major lenders here have a very solid financial base. I am also pleased that the IMF has acknowledged the strengthening of the regulatory system in Ireland over the last number of years, which reflects the progress made by the Financial Regulator working with key stakeholders- including industry and consumers to ensure our regulatory system meets best practice international standards.

Role of the Insurance industry

I would like to next acknowledge the very important role of the insurance industry in both the domestic and the international marketplace. The insurance industry contributes to economic growth and national prosperity in many ways. The most immediately obvious is as a major employer. However, it is the services provided to the economy which illustrate the importance of the insurance industry best.

A world in which there was no means of transferring risk would impact very significantly on our business and personal lives. Insurance is one of those essential services without which the world as we know it would not properly function as it provides the necessary stability to enable us as an economy and a society to move forward with confidence. In addition, the insurance industry is the backbone of the private pensions system, providing the means for individuals to pool their savings in order to ensure they have a reliable income on retirement. It helps improve the trade off faced by savers between risk and expected return. In facilitating policyholders in this way the insurance industry is also acting as a supplier of capital to the broader economy. Capital is the lifeblood of the global economy, and having ready access to it enables companies grow, which in turn generates employment, and very importantly leads to increased tax revenue to fund the provision of many public services and investment in our infrastructure. Therefore insurance companies play a pivotal role in linking up the need of savers who want to smooth income over their lifetime and firms who need capital in order to grow their businesses. This connection is not always fully appreciated and results in a more efficient allocation of capital across the economy leading to improved productivity and competitiveness.

Solvency II

This leads me onto the Solvency II Directive which is currently being reviewed by the European Council. As you know this Directive is concerned, amongst other things, with the efficient allocation of capital. This I appreciate is a very important issue for the development of the insurance industry over the medium to long-term. Because of this, I have been conscious of the importance of prior consultation with key stakeholders here in Ireland. In this respect, a Solvency II working group comprising of representatives from industry, the Financial Regulator and my Department has been working closely since May 2006 in order to ensure that Ireland's broad interests in this area are best represented at EU level. In addition, the most recent quantitative impact study has received a good response from Irish industry and is now being used to inform developments at EU level.

As you are aware, insurance firms under Solvency II will be capitalised according to the risks of their portfolios and they must value their assets and liabilities according to economic principles. This will ensure that regulatory capital will be better aligned with the economic capital needs of the business which should therefore reduce the cost of capital for well managed firms. The more accurate allocation of capital to risk

under the new solvency regime is intended to help underpin the delivery of a more competitive single market to customers in the EU. For the insurance industry to be able to benefit from Solvency II, the new principles based approach will require companies to develop a much greater understanding of the risks inherent to their business as well the ability to be able to anticipate changes in their risk profile over time. By adopting this approach Solvency II is incentivising risk management and is providing the platform for a more efficient marketplace which should benefit industry and consumer alike.

Pensions

I would also like to touch upon pensions which I know the insurance industry have a particular interest in. An ageing population will represent a challenge to the sustainability of our pension system, as the task of financing increased provision falls to a diminishing share of the population. *Towards 2016* commits the Government to publish a Green Paper on Pensions which will set out the range of issues involved. The essential purpose of the Green Paper will be to stimulate debate. The consultation process that will follow its publication will allow all stakeholders to contribute towards shaping a framework for addressing the pension's agenda over the longer term. I am confident that the insurance sector will make a significant and productive contribution to this debate.

Benchmarking

Finally, from a public expenditure perspective I am aware that many of you have an interest in the public service pay benchmarking process. As the public service paybill continues to be the biggest single element in public expenditure accounting for around half of all current expenditure, I am very conscious of the significance of the work of the Benchmarking Body. It is my strongly held view that there is a need to ensure public service pay grows at an appropriate rate. Benchmarking is an integral part of this process. The first benchmarking process recommended average increases of 8.9%. This reflected the fact that for a period around 1999/2001 there was a tight labour market across the economy and a substantial number of private sector firms concluded pay deals significantly in excess of the standard terms of the national agreements then applicable. These conditions do not apply on this occasion. In addition the Benchmarking Body in making comparisons is likely to give greater weight to the value of the public service pension package in view of developments in relation to pensions across the economy in recent years. I expect that these considerations will be reflected in the Benchmarking Body's recommendations on this occasion which is expected to be completed towards the end of 2007.

In conclusion, I would like to thank you again for giving me the opportunity to address your conference. You can rest assured that my top priority is to do everything I can to maintain a stable and healthy economy over the medium to longer-term, and that I am not underestimating the challenge involved. I hope the rest of your conference is a beneficial and worthwhile experience for all concerned.

Thank you