

Tax bonanza allowed for clearing of old debts

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Last week's announcement of the Exchequer results for 1998 revealed an embarrassment of riches. Instead of needing to borrow £89 million, as had been forecast in the budget of 1997, the government had a surplus of £747 million in 1998, a margin of error in the right direction of £836 million.

Even in the context of total government expenditure—depending on how you measure it—of about £17,000 million, this is a very strong result.

Some comment during the week focused on the fact that this was a better outturn than had been anticipated even as recently as last December's budget, but in truth, this was a side-show to the main event.

Other commentators pointed to greater than forecast revenue from income tax and VAT as the driving forces behind the unexpected surplus. Indeed no one had imagined that an extra 95,000 people would be in employment last year, with knock-on positive effects for tax revenue.

But this is only part of the story. The real surprise should be that these sorts of surpluses didn't happen sooner. Tax revenue has consistently exceeded expectations in the last few years, but up to this year it has been pre-empted to some extent by certain types of expenditure.

Governments in the last few years have used much of the tax bonanza to pay off some old liabilities of semi-state companies and for other debt management operations. These transactions have received less attention than they might merit. This is best appreciated by examining the record for the last few years.

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Table 1: Budget Targets

	1996	1997	1998
	IR £million		
More (+)/less(-) than budgeted			
(a) Central Fund Services	+107	+431	+31
(b) Supply Services	+40	+193	-7
(1) Total Current Expenditure (a) + (b)	+147	+624	+24
(2) Total Current Receipts	+520	+1035	+1006
(3) Capital Borrowing	+82	+11	+146
<i>Giving ...</i>			
Exchequer Borrowing Requirement			
less than budgeted by			
i.e., (2) minus (1) minus (3)	292	402	836
<i>Memo items:</i>			
EBR: Budget target	-729	-637	-89
EBR: Outturn	-437	-235	747
<i>Note: some totals not exact due to rounding</i>			

Some of the gory details are in the accompanying table, which shows by how much budget targets were missed for key items. Overall, government borrowing was less than expected by roughly £300 million in 1996, £400 million in 1997, and, as noted above, £836 million in 1998, generating an overall surplus.

In the first two years total current receipts, which includes both tax and non-tax revenue, were greater than forecast by about half a billion and then one billion pounds.

The table shows that this extra revenue was used in 1996 and 1997 to only a limited extent to fund what we typically think of as government expenditure—the ‘Supply Services’ category. In those two years, much of the real action was under the category ‘Central Fund’.

The Central Fund is expenditure which does not need to be renewed by an annual vote of the Dáil, but is authorised by continuing statute, as it is seen as the first charge on the Exchequer, before other liabilities are met. Items like debt service and Ireland’s contribution to the EU budget appear here.

Within this category, there are swings and roundabouts. In 1996 there were unexpected savings on the EU budget and debt service, and these paid for about half of an extra £103 million for the An Post and Telecom Éireann pension funds and an extra £100 million for the Small Savings Reserve Fund.

The other half, £107 million over budget in the table, was paid for by the extra tax revenue that year, as was extra capital expenditure, £22 million of which was for Bord na Móna restructuring. Similar transactions, but on a larger scale, happened in 1997. On that occasion, total current revenues were £1 billion above the budget-day targets, again mainly due to underestimating the scale of employment growth in the economy.

Half of this bonanza was allocated for expenditure not planned at budget time. Some £305 million went to the An Post and Telecom Éireann Pension funds, and £208 million to the Small Savings Reserve Fund, expenditure which had not been anticipated in the relevant budget. This first transaction completed the Exchequer’s outstanding business with the semi-state pension funds in question.

Other savings in 1997 meant that the total extra Central Fund Expenditure was £431 million, delivering an Exchequer Borrowing Requirement of £235 million, rather than a surplus of about £200 million had the above decisions

not been made.

This is where the real story about 1998 is: while the unbudgeted extra current revenue, at about £1 billion, was on the same scale as the previous year, there were no calls to discharge Exchequer liabilities which had lurked under the surface before.

The Central Fund showed a slight overrun, as savings on debt service almost offset a larger than expected EU budget contribution from Ireland. Some extra capital expenditure was undertaken for the Department of Education and Science, and for the Office of Public Works, but current expenditure turned out to be under budget, so that most of the extra revenue showed up for the first time in the overall balance, and transformed a tiny planned deficit into a large surplus.

Undoubtedly, the transactions mentioned above simply relate to the central government sensibly discharging certain outstanding liabilities and making prudent debt management provision when revenue surges allowed this to happen without affecting services already budgeted for. The pattern of revenue indicates that the precise timing of the Exchequer surplus in 1998 is somewhat illusory. Other debt management strategies could have changed the optics.

All of this is well understood by financial market participants, including European Central Bank officials monitoring the government's overall fiscal performance, who would have relied upon the General Government Balance concept, which indeed showed a surplus in 1997.

Despite the fact that these transactions are highlighted in the relevant budget documentation, one wonders whether they have been fully appreciated in Irish political circles. It is worth pointing out that these transactions related to sums which if in contention in the context of the magnitude of tax concessions, or extra departmental spending, would undoubtedly have received far more attention politically.

Yet it appears possible for ministers for finance to allocate hundreds of millions of pounds at year end, to buy off the ghosts of public sector Christmases past, without a squeak from social partners, or the opposition, if there is one.

In part, this may reflect the relative opacity of some presentations of the government's financial accounts, which despite some changes, are still the insomniac's best friend.

Furthermore, the formal parliamentary budgetary process is still overwhelmingly structured by the consideration of individual departmental votes, which relate only to the Supply Services category above, rather than by managerially relevant procedures which might enable legislators to see the wood for the trees.

It would appear that the *status quo* accords a considerable information advantage, and thus political discretion, to Department of Finance officials over and above their nominal political masters. At one level, this is understandable, given the risk that unexpected surpluses might be frittered away by politically-driven expenditure.

However, it is hardly the best preparation for the contingency of future budgetary difficulties if and when the Celtic Tiger turns into a pussycat.

http://www.aidankane.net/writingsetc/1999_kane_tax_bonanza.html