PBO Preliminary review of Budget 2020

PBO Publication 58 of 2019

This Note is the Parliamentary Budget Office’s immediate Budget Day analysis of Budget 2020. It summarises some of the main measures announced in the Budget, as well as providing an initial analysis of some these measures and the Budget overall.

Budget 2020 is a complicated document, as a number of the announcements made are only to be introduced in the event of a ‘No Deal’ Brexit. The PBO have analysed the key spending changes announced on Budget day, followed by the tax decisions which provide the funding for these. The macroeconomic context and fiscal stance of the Budget are then explained. Brief details of other documents published on Budget day are also referenced.

### Key Spending Changes

**Overall, Exchequer Spending in 2020 is expected to be €80 billion**

This spending is made up of:

- Voted Spending of €70.2 billion, including:
  - €62 billion in voted current spending;
  - €8.1 billion in voted capital spending;

- Non-Voted Spending of €9.9 billion, made up of:
  - €8.6 billion in non-voted current spending;
  - €1.2 billion in non-voted capital spending.

The key area of interest is voted current and capital expenditure. This spending facilitates the provision of most public services and infrastructure development / maintenance.

**Reacting to a disorderly Brexit brings Voted Spending to over €71 billion**

Budget 2020 makes a distinction between ‘core’ voted expenditure and expenditure that is a direct response to a disorderly Brexit. This means that the total gross voted expenditure envisaged under Budget 2020 is €71.4 billion, an increase of 7.1% over the Further Revised Estimates for 2019. Excluding the Brexit related expenditure, the growth rate is 5.1%.

**Table 1: Gross Voted Expenditure 2019 and 2020, € 000s.**

<table>
<thead>
<tr>
<th></th>
<th>REV 2019</th>
<th>Budget 2020</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Gross Voted Expenditure</strong></td>
<td>66,633,300</td>
<td>71,393,000</td>
<td>4,759,700</td>
</tr>
<tr>
<td>&quot;Core&quot; Gross Voted Expenditure</td>
<td>66,633,300</td>
<td>70,004,000</td>
<td>3,370,700</td>
</tr>
<tr>
<td>Employment Affairs &amp; Social Protection</td>
<td>20,497,524</td>
<td>21,095,000</td>
<td>597,476</td>
</tr>
<tr>
<td>Health</td>
<td>17,107,260</td>
<td>18,255,000</td>
<td>1,147,740</td>
</tr>
<tr>
<td>Education &amp; Skills</td>
<td>10,767,187</td>
<td>11,128,000</td>
<td>360,813</td>
</tr>
<tr>
<td>All other Votes</td>
<td>18,261,329</td>
<td>19,958,000</td>
<td>1,696,671</td>
</tr>
<tr>
<td>Disorderly Brexit Response</td>
<td>N/A</td>
<td>1,220,000</td>
<td>N/A</td>
</tr>
<tr>
<td>Timing Related Cash Costs¹</td>
<td>N/A</td>
<td>169,000</td>
<td>N/A</td>
</tr>
</tbody>
</table>


¹ This relates to a technical calendar-related issue (number of public service paydays and social protection payment dates.)
The increase in ‘core’ spending is significantly above the forecasted (based on a disorderly Brexit) nominal GNI* growth in 2020 of 0.2%.

The PBO also pointed out in its Pre-Budget Commentary 2020 (pp.25-26), that growth in Gross Voted Expenditure exceeded growth in Modified Final Domestic Demand (MFDD) in 2018. As MFDD can be taken as a proxy for growth in the domestic economy, it would normally be prudent to avoid exceeding that rate. In the case that a disorderly Brexit does not happen, then Voted spending growth will continue at a significantly higher rate than projected MDD (~3.9%). If a disorderly Brexit does happen, then Voted spending growth at a much higher rate than MDD (>6.9% v. 1.7%) may be justifiable as a counter-cyclical response, that is to say that an increase in Government spending may be useful to counter the economic shock.

An amount of €1,220 million is set aside to address a disorderly Brexit

The broad headings under which this amount will be spent in 2020 are:

- Temporary targeted measures: €650 million – aimed at Agriculture, Enterprise and Tourism;
- Necessary Compliance checks: €160 million – Ports, Customs etc; and

Additional costs of approx. €50 million related to compliance check staffing have been allocated to Vote groups. Otherwise, it was announced that the allocation of these disorderly Brexit funds will be detailed in the Revised Estimates for Public Services 2020 to be published just before Christmas – this seems to be an early point in time to apportion this spending.

A total of €440 million in recurring spending overruns in Health, Education & Skills and Justice expected in 2019

Budget 2020 projects Supplementary Estimates of:

- €335 million, €50 million and €55 million in the Health, Education & Skills and Justice Vote Groups, respectively. This money will, effectively, go into the base expenditure for these Vote groups;
- Another €125 million is expected to be needed for the Christmas Bonus under the Employment Affairs and Social Protection Vote; and
- Another €30 million is required for non-recurring costs in other Departments, including Finance and Transport, Tourism and Sport.

This €595 million in additional expenditure is offset by underspends of €150 million across other Vote Groups, and additional Appropriations-in-Aid of €75 million. This means that a net amount of €370 million is estimated to be required to fund the Supplementary Estimates for 2019.

An additional €384 million for Transport, but capital ceiling reduced by €115 million

The Department of Transport, Tourism and Sport (DTTAS) has received an additional allocation of €27.6 million in current expenditure and €356.7 million in capital expenditure. This is a significant increase of 22.5% in capital expenditure allocation year-on-year but is a reduction of €115 million from the capital expenditure ceiling for the Vote Group published in Mid-Year Expenditure Report 2019. Budget 2020 refers to this as “re-profiling” of €125 million capital expenditure partially offset by new resources of €11 million. Little detail is given about the practical implications of this change.

Most of this additional funding is being directed towards land transport capital projects, which will receive an additional €354 million in capital funding in 2020. An additional €14.4 million in current expenditure for sports

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2 Table A11, Budget 2020: Economic and Fiscal Outlook, p. 57.
3 Appropriations-in-Aid includes income and receipts generated by Departments – see PBO Note 18 of 2018.
is offset by a reduction of €14.4 million in capital expenditure. Finally, the Tourism Programme is receiving an addition €17.2 million in capital expenditure, an increase of 44% in capital funding. The new capital investment is expected to progress existing public sector transport progress, while details of the planned usage of the capital funding for tourism are not provided. The only measures specified in the financial statement are €9 million for sustainable mobility projects and €3 million for electric vehicle infrastructure.\(^4\)

Table 2: Revision of the 2020 Ministerial Expenditure Ceiling for Transport, Tourism and Sport, Mid-Year Expenditure Report 2019 to Budget 2020.

<table>
<thead>
<tr>
<th></th>
<th>MYER 2019</th>
<th>Budget 2020</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Voted Current Expenditure</td>
<td>756</td>
<td>783</td>
<td>27</td>
</tr>
<tr>
<td>Gross Voted Capital Expenditure</td>
<td>2058</td>
<td>1943</td>
<td>-115</td>
</tr>
<tr>
<td>Total Gross Voted Expenditure</td>
<td>2814</td>
<td>2726</td>
<td>-88</td>
</tr>
</tbody>
</table>


Further details on how the money announced in Budget 2020 will be spent by DTTAS (and other Departments) would be welcome.

Communications, Climate Action and the Environment budget has increased by 16%

This includes a 36.6% (€99 million) increase in the capital budget. These additional funds are allocated for increases in investments including:

- National Broadband Plan;
- Climate action measures such as electric vehicle grants and network enhancements; and
- Energy efficiency upgrades in the residential, commercial and public sector.

A large part of this increased capital budget will be funded by revenue received from increased carbon taxes. Revenue from carbon taxes is to be ring-fenced for climate action measures such as the Just Transition Fund in the Midlands and Peatland Rehabilitation. Many of these measures fall under this Department’s expenditure.

Voted Health Budget has increased by €1.1 billion (+6.7%) – from €17.1 billion to €18.3 billion

Of the €1.1 billion increase, €480 million is pay-related. This is an increase of 6%, well above the 1% increase in staff numbers. The PBO has estimated that a 2% increase was needed due to demographic change; therefore two-thirds of the total increase is due to non-demographic factors.

Of this two-thirds increase, a portion will fund policy measures such as:

- Lowered prescription charges;
- Increases in medical card income thresholds for over 70s;
- Decrease in Drug Payment Scheme threshold; and
- Free GP for under 8s and free dental care for under 6s.

An increase of €25m was allocated to the National Treatment Purchase Fund to tackle acute waiting lists. As previously discussed, a Supplementary Estimate of €335 million (or 2% of the original 2019 Budget) will shortly be requested from the Dáil.

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\(^4\) Statement of the Minister for Finance and Public Expenditure and Reform, 8 October 2019, p. 21
Employment Affairs & Social Protection budget has increased by almost €600 million (+3%)

The budget for Employment Affairs & Social Protection has increased from €20.5 billion in 2019 to €21.1 billion for 2020. This annual increase of almost 3% is similar in scale to increases seen in previous years (an increase of 2.4% arose between 2018 to 2019).

In addition to addressing demographic costs, the increase in allocation will fund a number of increases in social protection benefits such as:

- Fuel Allowance;
- Targeted activation measures;
- Jobseekers Allowance rates, for certain age groups; and
- Lone Parents & Working Family Payment income thresholds.

Estimations of Demographic Cost Pressures are still based on a 2016 Analysis

Additional costs due to demographic change in Health, Education & Skills and Employment Affairs & Social Protection are based on findings from the IGEES paper published in 2016. This paper uses population figures which have since been updated. The PBO has previously pointed out that this analysis (particularly in relation to health expenditure) is limited in scope and may not represent true demographic cost pressures.

In the 2016 paper, it was estimated that the demographic cost pressure for Education would be €20.8 million in 2020. Within Budget 2020, however, an increase of at least €53.2 million has been allocated for demographic change in the Education Vote.

It was expected that updated demographic cost analysis would be published alongside the budget to feed into future analysis. At the time of publication on Budget night this updated analysis has not yet been published.

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5 Department of Public Expenditure and Reform (2016) Budgetary Impact of Changing Demographics 2017-2027
6 €20m for additional school places, €26m for School Transport Scheme and €7.2m (PBO calculated) for additional teachers.
Tax Changes

Tax changes included in Budget 2020 are targeted to specific sectors

- Budget 2020 contains revenue raising measures of approximately €529.6m (in a full year), and revenue reducing measures of approximately €174.2m (in a full-year). This results in a net revenue gain of €355.4m.

Relative to the SPU (based on an orderly Brexit), tax revenues for 2020 (net of Customs) are projected to be 2.2% lower under a disorderly Brexit

- Overall tax revenue is expected to grow by 4.3% in 2020, driven largely by a significant increase in Customs revenue relative to 2019 (of 239%). This reflects the structural change in the trading relationship between the UK and Ireland, under a disorderly Brexit.

- Excluding Customs revenue, overall tax revenue growth for 2020 is a modest 2.1%, considerably below the average annual growth rate of 6.5% from 2016 to 2019. The average annual growth in tax revenues (excluding Customs) from 2021 to 2024 is predicted to be 4.5%.

- Disaggregating the largest tax categories:
  - Income Tax is expected to grow by €990m in 2020 (or 4.3%). The forecast of Income Tax in Budget 2020 is 1.2% lower than SPU. This reflects robust growth in wages for 2020 (of 3%), despite a moderation in employment growth (to 0.8%).
  - Moderate growth is expected for transaction based taxes, such as VAT (2.1%) and Excise Duty (0.9%). The projected revenues from these taxes presented in Budget 2020 are, on average, 3% lower than SPU. This reflects a moderation in consumer spending under a disorderly Brexit (by 1.3 percentage points).
  - It is also worth noting that the proposed change to Excise on tobacco products is expected to raise €57.1m in a full year.
  - Capital Acquisitions Tax is projected to fall by 4.8% in 2020, while Capital Gains Tax is projected to grow by 0.5%. These forecasts have been revised down since SPU, by 4.8% and 3.3% respectively.
  - Corporation Tax is expected to grow by 2.5% in 2020, revised up from SPU by 0.67%. This reflects the extent to which Corporation Tax is concentrated among multinational companies (accounting for 77% of revenue in 2017), which are less impacted by a disorderly Brexit. In addition, changes introduced in Budget 2020 are expected to increase yield by €174m (in a full-year).

- It is unclear if forecasts of tax revenue for 2019 account for the impact of a disorderly Brexit in Q4, despite the current Brexit date of October 31 (in fact, overall tax revenue has been revised upward for 2019 since the SPU, by 0.31%).

- In terms of fiscal forecasts generally, the PBO would welcome an annual review of the Department of Finance’s performance in tax forecasting. There have been sizeable forecast errors in recent years, for more cyclical taxes (Corporation Tax and Capital Taxes). The publication of an assessment by the Department of the source of forecast errors (e.g. issues relating to the underlying macro-driver used to predict receipts, or the inaccurate costing of policy changes), would facilitate greater scrutiny of revenue forecasts.

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7 80% of revenue from Customs is returned to the EU, while 20% is retained to cover administrative costs.
The PBO welcomes efforts in Budget 2020 to broaden the tax base

- This is being achieved via increases in relatively stable revenue sources including:
  - the increase in the Carbon Tax, and the equalisation of electricity tax between businesses and non-businesses;
  - the increase in Excise on tobacco products; and,
  - Compliance measures in respect of Corporation Tax and changes to Dividend Withholding tax.

- However, additional measures included in the Budget risk contributing to a narrowing of the base. These include:
  - An extension/expansion of certain tax expenditures (i.e. the Key Employee Engagement Programme, the Employment and Investment Incentive, the R&D Tax Credit, the Special Assignee Relief Programme, the Foreign Earnings Deduction, and the Help-to-buy Scheme);
  - An increase in the Home Carer and Earned Income tax credits; and,
  - An increase in the Group A tax-free threshold in respect of Capital Acquisitions Tax.

The PBO notes that planned allocations to the Rainy Day Fund (of €500m) for 2019 and 2020 will no longer be made

- The Rainy Day Fund will still be capitalised with €1.5bn from the Ireland Strategic Investment Fund. The Budget document details that this €1.5bn will be used to fund Brexit supports should additional borrowing (arising from a larger deficit) become “counter-productive”. The PBO queries if the Rainy Day Fund should instead be deployed prior to raising additional funds from borrowing.

The PBO welcomes improvements made in the information provided in respect of tax expenditures, but notes other information has become less clear

- The PBO welcomes improvement made in the reporting on tax expenditures, in terms of the quantity and quality of the information provided. This follows engagement between the PBO and Budget Oversight Committee, with the Department of Finance and the Revenue Commissioners.

- However, the PBO also notes that some changes to tax expenditures introduced in the Budget have been costed on aggregate, and not on an individual basis. This makes scrutiny of the cost of each measure impossible. In addition, no costing has been provided for the extension of living city initiative, which was due to end May 2020.

Substantial additional documentation was published alongside Budget 2020

- Reviews of the following tax expenditures were published alongside Budget 2020: SARP; farm restructuring; home carers tax credit; FED; and the CGT entrepreneur’s relief. The annual SARP report was included in the review document.

- A number of documents were published alongside the Budget, however the relevance to Budget 2020 is unclear. 17 Spending Review papers were published alongside the Budget, covering (among other topics): Tusla, Emergency Departments, Public Service Employment and Expenditure Modelling, Civil Defence Expenditure, Multi annual budgeting for An Garda Síochána, costing of the expansion of free GP care, equality budgeting, Domiciliary Care Allowance, trends in the Housing Assistance Payment, and Live Register analysis.

- Finally, reports were published on Corporation Tax, the report of the working group on USC and PRSI amalgamation (dated September 2018) and an ESRI report on potential options for revenue rebates from carbon tax.
The macroeconomic context and fiscal stance

The Economic and Fiscal Outlook published with Budget 2020 includes the Department of Finance’s Autumn Economic Forecasts. These forecasts (for 2019 and 2020) were endorsed by the Irish Fiscal Advisory Council. The central assumption underpinning the macroeconomic forecasts is that no agreement will be reached regarding the UK’s exit from the European Union. This will result in a ‘disorderly Brexit.’

The economy will continue to grow in 2020 under a ‘no-deal’ scenario. However, this growth will be weaker than it otherwise would have been. Under a ‘no-deal’ scenario, GDP growth will slow to 0.7% in 2020. This is significantly lower than a ‘deal scenario’ where it is projected to grow by 3.1%. Employment growth for 2020 is expected to slow from 1.7% (‘deal’ scenario) to 0.8% (‘no-deal’ scenario). A ‘no-deal’ Brexit will also lead to a higher unemployment rate in 2020 (5.7% v 5.1%).

Macroeconomic risks have increased in Budget 2020, compared to SPU 2019. The major risks are listed below (with likelihood in Budget 2020 and SPU 2019 mentioned in the brackets):

- Deeper global downturn; (High in Budget 2020, Medium in SPU 2019);
- Geopolitical Factors; (Medium in Budget 2020 and SPU 2019);
- Disruption to world trade; (High in Budget 2020, Medium in SPU 2019);
- Larger impacts of Disorderly Brexit; (High in Budget 2020, Medium in SPU 2019);
- Concentrated production base; (Low in Budget 2020 and SPU 2019);
- Loss of competitiveness; (Medium in Budget 2020 and SPU 2019);
- Housing supply pressures; (High in Budget 2020, Medium in SPU 2019); and
- Overheating economy (Medium in Budget 2020 and SPU 2019).

General Government Balance

The Government is planning a small Budget surplus in 2019 of €670 million or 0.2% of GDP. This is an increase from €170 million in 2018 (0.1% of GDP). The government general balance will move into a deficit of €2.02 billion in 2020 (0.6% of GDP) due to a disorderly Brexit.
Fiscal Rules

Under the EU Fiscal Rules, Ireland must meet the Medium-Term Objective - MTO (i.e. maintain a structural deficit of 0.5% of GDP).

Looking at estimates for the structural balance based on the Department of Finance’ estimates of the economic cycle (i.e. output gap), Ireland is expected to be at its Medium-term objective in 2020.

However, using the output gap estimates based on the Commission methodology (CAM), the MTO won’t be reached until 2021. Ireland was expected to reach the MTO in 2020. However, a ‘no-deal’ Brexit and the policy response to it will result in a larger structural deficit in 2020 (-0.8% compared to -0.4% in SPU 2019).

Based on Budget 2020, there appears to be a breach of the Expenditure benchmark for 2020 (of 0.3% of GDP), but the deviation will not be significant (0.5% of GDP).

Table 3: Summary of Output Gap and Structural Balance

<table>
<thead>
<tr>
<th>Per cent of GDP</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
</tr>
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<tbody>
<tr>
<td><strong>Department of Finance’s Alternative Methodologies</strong></td>
<td></td>
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<tr>
<td>Output Gap</td>
<td></td>
<td></td>
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<tr>
<td>SPU 2019</td>
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<td>0.8</td>
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<td>0.5</td>
<td>1.3</td>
<td>1.9</td>
<td>2.1</td>
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<tr>
<td>Structural Budget Balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SPU 2019</td>
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<td>-0.1</td>
<td>1.0</td>
<td>0.2</td>
<td>0.2</td>
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<tr>
<td>Budget 2020</td>
<td>-0.4</td>
<td>-0.4</td>
<td>-0.5</td>
<td>-0.7</td>
<td>-0.7</td>
<td>-0.5</td>
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<td><strong>European Commission’s Commonly Agreed Methodology (CAM)</strong></td>
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<td>Output Gap</td>
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<td></td>
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<td></td>
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</tr>
<tr>
<td>SPU 2019</td>
<td>2.5</td>
<td>1.6</td>
<td>1.0</td>
<td>0.5</td>
<td>0.0</td>
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<tr>
<td>Budget 2020</td>
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<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
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<tr>
<td>Structural Budget Balance</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SPU 2019</td>
<td>-1.1</td>
<td>-0.4</td>
<td>0.2</td>
<td>0.7</td>
<td>1.3</td>
<td>n/a</td>
</tr>
<tr>
<td>Budget 2020</td>
<td>-1.3</td>
<td>-0.8</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.3</td>
<td>0.7</td>
</tr>
</tbody>
</table>

In previous years, Budget documents provided more details regarding compliance with the fiscal rules. As there is now more than one methodology (i.e. EU CAM and Department of Finance), a better breakdown would be useful in future Budgets. Fiscal rules are complex and efforts to improve accessibility and communication in the budget documentation would be welcomed.

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8 The Expenditure Benchmark (EB) rule holds that the net growth rate of government spending must be at or below a country’s medium-term potential economic growth rate.