Chief Economist Briefing

Budget 2003

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In this Briefing

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The Fiscal Targets: First Planned Deficit Since 1998

The Exchequer plans to borrow €1,869 million (1.4% of GDP) in 2003, the first planned borrowing since 1998. This compares with an Exchequer deficit of €193 million (0.2% of GDP) in 2002. The government had originally targeted an Exchequer surplus of €170 million (0.2% of GDP) for 2002.

Based on the EU definition of the general government balance, there is a planned deficit of €885 million (0.5% of GDP) in 2003 compared with the estimated deficit of €397 million (0.7% of GDP) in 2002. The original target for the general government balance in 2002 was for a surplus of €837 million (0.7% of GDP).

Before the announcement of today's budget measures, the Exchequer faced an opening deficit of €2,003 million (1.5% of GDP). Based on the EU definition, the opening general government deficit was lower at €642 million (0.5% of GDP). These figures were published last weekend in the White Paper on Receipts and Expenditure.

In today's budget the Minister has spent an additional €272 million on social welfare, €615 million on public service pay, and an extra €209 million on capital spending. He also announced income tax reliefs costing €141 million. He is financing this extra spending and tax reliefs by means of higher indirect and capital taxes amounting to €1,085 million (0.8% of GDP). Details are set out in Table 1 appended.

In net terms, the Minister is closing with a higher projected deficit than his opening position.

Assessment: Public Servants Walk Free

Any meaningful assessment of this Budget must be made in the context of budgetary and economic developments over the past few years and how these constrain our room for manoeuvre on both of these fronts in the future.

Key Points to Note are that:

The public finances have swung from an Exchequer surplus of €3,049 million (3% of GDP) in 2000 into a planned deficit of €1,869 million (1.4% of GDP) in 2003. In terms of the EU's general government balance, there has been a deterioration from a surplus of €4,567 million (4.4% of GDP) to a planned deficit of €885 million (0.7% of GDP) in 2003. This deterioration on both definitions is alarming.

The Exchequer is projected to be in deficit in 2003 because it plans to pay (i) €1,103 million for prefunding part of the future cost of social welfare and public service pensions, (ii) €565 million towards the cost of public sector pay benchmarking and (iii) about €550 million to savers under the SSIA scheme. All three of these measures are open to serious questioning under present economic and budgetary conditions. Under this Budget, the winners are public servants while most other groups have lost.

In the context of the constraints imposed by the terms of the EU Stability and Growth Pact, Ireland's projected deficit in 2003 will compare favourably with many of our EU partners.

Based on the medium-term public finance projections set out in today's budget document, Ireland is expected to run a general government deficit of 1.2% of GDP in both 2004 and 2005. These figures leave the government will little room for manoeuvre over the medium term.

The planned Exchequer deficit of €1,869 million represents the difference between a projected current budget surplus of €3,685 million (2.7% of GDP) and a capital borrowing requirement of €5,554 million (4.1% of GDP). Thus, the need to borrow arises for capital purposes. However, in light of Ireland's significant infrastructural deficit, which becomes all the more apparent on a daily basis, the capital budget needs to be higher with a correspondingly greater current budget surplus to pay for it. However, due to the excessive growth in current spending and the fall-off in the growth of tax revenue, the projected current budget surplus of €3,685 million in 2003 is well off the peak of €6,970 million reached in 2000.

The Minister did add to the capital programme in today's budget with an additional €209 million on the roads programme. This still implies a fall of 0.6% in net capital spending in 2002.

Over the three years to 2002, the growth in government voted net current spending was a cumulative 52%. This occurred at a time when the economy was reaching its peak and when the growth in tax revenue was unlikely to be sustained on the same scale as in earlier years. Nevertheless, the government persisted with its high spending strategy, coupled with significant tax reliefs. Budgetary policy was strongly pro-cyclical with the government stimulating an already overheating economy.

Budget 2003 is deflationary in the context of the figures released today. There are few benefits to the average tax payer and the lack of fiscal indexation will lead to a higher tax burden in 2003. Furthermore, since the erosion of the healthy budgetary position at the end of 2000, the budgetary outlook has increasingly acted to constrain the private sector. There is less transparencncy about budgetary trends, which the Department of Finance and the government seem at a loss to explain, and the fear of higher taxes now acts as a dampener on business and consumer confidence. The Minister showed by the wide ranging increase in taxes and the ending of capital allowances today that he is under pressure to raise revenue. His resort to a levy on the banks is a throw back to the ***"Bad Old Days".*** The government is now in a corner and there must remain considerable doubts about its ability to restore genuine fiscal stability which would in turn promote greater macroeconomic stability in Ireland.

Budget Adds 0.85% to Inflation

A key question is whether the Minister can achieve the targets set out in today's Budget. The projected growth in net current spending in 2003 has gone from a projected 6.6% on a pre-Budget basis to 9.9% after today's spending announcements on social welfare and public sector pay. Sticking within this limit will be the key test. On the revenue side, the pre-Budget tax revenue forecast of 3.9% has risen to 7.9% on a post-Budget basis as a result of the various tax measures on capital and indirect taxes. Overall, the Department of Finance's forecast for the economy in 2003 (GDP growth of 3.5%) seem realistic as do the tax forecasts.

The Budget has added significantly to inflation. We expect that the average rate in 2003 will be 5% compared with the official forecast of 4.8%. Such a high rate of inflation will not help the negotiations of a new wage settlement in 2003.

Initiatives to Cause Concern for Business

From a business perspective there are a number of initiatives which will cause concern. With effect from 1 January 2003, the 12.5% VAT rate will be increased to 13.5%. This will impact on many labour intensive services sectors, in particular tourism but also construction.

A number of measures will impact negatively on investment and entrepreneurial activity. A range of tax incentive investment schemes from urban renewal to park and ride schemes, buildings used for student accommodation and the film relief scheme will be terminate on 31 December 2004. The regime of capital allowances of 15% per annum over 7 years in respect of hotels and holiday camps will be terminated with immediate effect. Capital allowances for holiday cottages will be terminated with immediate effect. This will hit the tourism sector, which is already experiencing difficult trading conditions.

The write off period for capital allowances for plant and machinery has been extended from 5 to 8 years, i.e. in future an allowance of 12.5% p.a. on a straight line basis will apply.

Stamp duty on non-residential property is to be increased from a flat rate of 6% to a range of 7-9%, raising an extra €158 million in a full year. Recent data show that circa €600 million was invested in commercial property in Ireland in 2002. However, over twice this amount was invested in the UK. The stamp duty increase could further encourage this investment outflow.

The banking and financial services sector was hit through the introduction of a new levy, aimed at raising €100 million per annum for the next three years. Taxes on credit, debit and ATM cards and cheques were also drastically hiked. The increases are expected to add another €50 million to government revenue.

On the positive side for construction, the minister is to allow an additional €209 million to the National Roads Programme next year, bringing to €1.25 billion the total level of investment in 2003. The government also plans to explore more radical and innovative measures aimed at widening the scope for greater private sector investment in the roads programme.

As already provided for in the 1999 Budget and Finance Act the standard rate of corporation tax will be reduced from 16% to 12.5% from 1 January 2003.

Notwithstanding our reservations on how this is being done, the government's attempts to stabilise the public finance will also be welcomed by the business sector. In a recent survey of CEO's in the top 1,000 Irish companies conducted by Insignia Richard Ellis Gunne, 46% of respondents identified government finances as the most critical issue needing to be addressed by Government over the next three years.

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Table 1- Cost of Budget Day Adjustments (€ Million)

Net Current Expenditure		Taxation	
Opening Position	28,077	**Opening Position**	31,478
Less Departmental Balances	30	*Less Income Tax Reliefs*	141
Plus Public Service Pay	615	*Plus Indirect Tax Measures*	498
Plus Social Welfare Increases, etc	302	*Plus Other Tax Measures*	587
		Add Revenue Buoyancy	227
Post-Budget Forecast	28,964	Post-Budget Forecast	32,649

1.	Opening Current Budget Surplus	3,402
2.	Projected Post-Budget Current Surplus	3,685
3.	Opening Capital Exchequer Borrowing	5,405
4.	Projected Post-Budget Capital Exchequer Borrowing	5,554
(1-3)	Opening Exchequer Balance	-2003
(2-4)	Projected Post-Budget Exchequer Balance	-1869

Table 2 - SUMMARY BUDGET 2002 – 2003 (€m)

	2002 Outturn	**2003 * Opening Position**	**Post Budget 2003 Target**	**% Change Post Budget 2003 over 2002 Outturn**
Current Spending				
Central Fund (*Incl. National debt interest*)	2,920	3,682	3,682	26.1
Supply Services	23,425	24,394	25,282	7.9
Total Current Spending	26,345	28,076	28,964	9.9
Current Revenue				
Tax	29,336	30,475	31,646	7.9
Of which :-				
- Income Tax	*9,106*	*9,272*	*9,307*	*2.2*
- VAT & Excise Duty	*13,281*	*14,079*	*14,636*	*10.2*
- Corporation Tax	*4,925*	*4,601*	*5,068*	*2.9*
		5,042		
Non-Tax	2,173	1,003	1,003	-53.8
Total Revenue	31,509	31,478	32,649	3.6
Current Budget Surplus	5,164	3,402	3,685	
Capital Borrowing	5,356	5,405	5,554	
Exchequer Balance	-193	-2003	-1869	
(% of GDP)	(-0.2)	(-1.5)	(-1.4)	
Gen. Govt. Balance	-397	-642	-885	
(% of GDP)	(-0.3%)	(-0.5)	(-0.7)	