Government revenues in Ireland since the financial crisis

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Abstract

This letter examines trends in government revenues during and after the financial crisis. On taxation, it highlights the strong increase in income tax receipts in recent years. Relying on stable sources of revenue — rather than cyclically sensitive ones — appears desirable from a public finance perspective and reduces a key vulnerability that developed in Ireland in the mid-2000s. There has also been a sharp increase in non-tax revenues since the crisis partly due to measures introduced by the Government to assist the financial sector. This assistance has significantly added to the public debt ratio, the high level of which remains a key vulnerability for the economy. Accordingly there would appear to be a strong case that unexpected gains from these sources be used to exclusively reduce public debt. Similar arguments could be made in relation to any future income receipts arising from either the IBRC related Special Portfolio and the expanded Asset Purchase Programme.

1 Introduction

The past decade has been a turbulent one for the public finances. Ireland’s large budgetary surplus in the middle of the last decade quickly reverted to sizable deficits with the onset of the crisis. This culminated in entry into an Excessive Deficit Procedure (EDP) in 2009 and entry into an EU-IMF assistance programme in 2010. A significant budgetary adjustment was required to put the public finances back on a more sustainable footing, with consolidation measures of around €30 billion being introduced between 2008 and 2014. With the General Government (GG) deficit expected to fall below the critical 3 per cent EDP threshold this year, this letter examines the evolution of government tax and non-tax revenues, over the past few years. Section 2 examines trends in Exchequer taxes since 2007. Non-tax revenue sources and their increasing importance are considered in Section 3.

1 Corresponding authors: ronan.hickey@centralbank.ie and diarmaid.smyth@centralbank.ie. The views expressed in this letter are those of the authors only and do not necessarily reflect the views of the Central Bank of Ireland (CBI). We would like to thank Stephen Byrne, Mary Cussen, John Flynn, Reamonn Lydon and Gerard O’Reilly (CBI) and Rod O’Mahony, Patrick Quill and Gillian Roche (CSO) for comments received. All remaining errors are our own.
2 Recent Trends in Tax Revenue

The first half of the 2000s saw the introduction of policy measures which had a profound impact on the structure of tax revenue in Ireland. While total Exchequer tax receipts accelerated at a rapid pace during the period, growing by 75 per cent between 2000 and 2007 (see Figure 1), the proportion coming from relatively stable sources such as income tax steadily declined to be replaced by more cyclically sensitive tax heads.2

Figure 1: Exchequer Tax Revenue, 2000 to 2014

The contribution from income tax went from representing one-third of total tax revenue in 2000 to just one-quarter in 2006, as large numbers of workers were removed from the tax net. Income tax developments over this period are discussed in more detail by Cronin et al (2015), Honohan (2009) and O’Connor (2013).3 The contribution from stamp duty and capital gains tax, by comparison, doubled in the first half of the decade against the backdrop of the booming housing market, while VAT receipts grew sharply, again partly reflecting activity in the housing sector (see Addison-Smyth and McQuinn, 2010). This resulted in a significant rise in the broader General Government (GG) revenue to GDP ratio in the 5-year period to 2006 (Figure 2), reversing the declining trend of the previous five years.4

Figure 2: General Government Revenue, 1995 to 2014

The increasing reliance on property dependent taxes (VAT, stamp duty and capital gains tax) meant that the sensitivity of revenues to cyclical conditions in the economy became unusually high. This left the Irish tax base increasingly vulnerable to both internal and external economic shocks and ensured that the housing market crash, and subsequent movement into recession, had a much bigger impact on the fiscal position than would have otherwise been the case.

2It should be noted that, in Exchequer terms, PRSI receipts are treated as an appropriation-in-aid and are netted off government expenditure. Accordingly they are not represented in the tax or non-tax data presented here.

3Cronin et al highlight the important role that increasing tax credit measures played in reducing receipts, while Honohan illustrates the considerable drop in the average income tax rates that occurred across all income thresholds. O’Connor examined the structure of the Irish taxation system including options for reform.

4GG aggregates provide a more accurate depiction of fiscal performance as they encompass all arms of government.
wise been the case. Tax revenue contracted dramatically between 2007 and 2010, falling by one-third to €32 billion, while the share of total revenue as a per cent of GDP declined by around 3 percentage points to 33.6 per cent. Figure 3 takes a closer look at the major tax heads to see how they have evolved since the start of the downturn, taking 2007 as a base year.

Figure 3: Change in Major Exchequer Tax Heads, 2007 to 2014 (2007=100)

All tax heads contracted sharply with the onset of the financial crisis, with the decline in ‘other’ taxes (mainly composed of stamp duties and capital gains tax) especially severe at 75 per cent in 2010, reflecting the collapse in the housing market. By comparison, the contraction in income tax was smaller at 17 per cent over this period. Even if the introduction of the income levy in 2009 is excluded, the 28 per cent decline in income tax was amongst the lowest of all the major tax heads. This was in spite of a 15 per cent drop in employment over the same period, highlighting its important role as a relatively stable source of revenue.

The recovery in tax receipts since 2010 has reflected a combination of policy measures and stronger economic activity, with total tax receipts surpassing the €40 billion threshold for the first time in six years in 2014 (they nevertheless remained some 13 per cent below their peak, highlighting the magnitude of the contraction that occurred during the crisis). While the taxation measures introduced were primarily an emergency response to the crisis, they also served as steps to correct the structural problems. Figure 3 shows that the recovery in revenues has been driven by developments in income tax, which is the sole major tax head to have surpassed its pre-crisis level. In fact it has done so significantly, growing by 26 per cent since 2007. The introduction of the Universal Social Charge (USC) in Budget 2010 has played a very significant role in this recovery. Data from the Revenue Commissioners reveals that the USC was responsible for 21 per cent of the €17 billion of income tax generated in 2014, and almost 40 per cent of the increase between 2010 and 2014. Changes in PAYE, by comparison, drove half of the increase over

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5 This includes the income levy - the precursor to the USC. Between 2010 and 2014 income tax increased by €5.9 billion. The USC/income levy generated €2.2 billion of this change while PAYE generated €3 billion.
this period. ‘Other’ taxes, meanwhile, have experienced the weakest recovery and were still less than half of their 2007 value in 2014. This figure would have been even lower but for the contribution made by the levy on private pension funds to stamp duty in recent years, and the introduction of the property tax.

As Figure 4 shows, these recent developments have ensured that the more stable income tax head is now providing a much larger proportion of total taxes. Following the introduction of the USC, its share increased to 41 per cent and has remained broadly stable since. Interestingly VAT and other taxes are now broadly back to their share of total revenue at the start of the 2000s, while corporation tax and excise duties have experienced small declines. Recent years have also seen a pick-up in the total GG tax revenue to GDP ratio, although at 34.9 per cent in 2014 it remained below both the peak in 2006 and its value at the start of the decade (36.9 and 35.9 per cent respectively). This partly reflects the composition of the fiscal consolidation measures introduced; approximately two-thirds of the consolidation has been expenditure driven.6

3 Recent Trends in Non-Tax Revenues

In recent years non-tax revenues have become an increasingly important source of income for the Government. On an Exchequer basis, non-tax revenues increased from €0.6 billion in 2007 to €3.0 billion in 2014, rising to 6.7 per cent of Exchequer current revenue (from 1.3 per cent in 2007).7 These receipts incorporate a broad range of items, including interest and dividend revenue. However as Figure 5 shows, the most important items in recent years have been bank guarantee fees and, increasingly, Central Bank surplus income.8

Figure 5: Composition of Exchequer Non Tax Revenue, 2007 to 2014

Much of the increase in non-tax revenues has reflected monies accruing to the Government as a result of assistance provided to the financial sector. While the costs of the measures taken to recapitalise the banks have been well documented, receipts arising from banking interventions are less well known. The CSO have estimated that measures taken to support financial institutions, resulted in inflows of €12.9 billion between 2009 and 2014.9 This mainly consisted of bank guarantee fee income.

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6 See Department of Finance (2011).
7 Exchequer current revenue refers to tax and non-tax Exchequer receipts discussed in this letter. In 2014, there was a transfer of funds from local government to Exchequer non-tax revenues amounting to €520 million. The Exchequer also benefits from capital receipts; these have increased sharply in recent years due to bank transactions and inter-governmental transfers which do not affect the GG position.
8 Approximately 80 per cent of Central Bank surplus income is remitted to the Exchequer. From a GG perspective, surplus income is classified into current and capital government receipts with only the former used to reduce the GG deficit.
9 These figures are on a GG basis and are made available in Table 1 of the annual Government Finance Statistics release published by the CSO.
undoubtedly helped to cushion the marked decline in other sources of income over the crisis period. They have also helped to ensure that fiscal targets under the EDP have been complied with. As a means of highlighting this, in Figure 6 we plot unexpected gains against the EDP over performance.

Figure 6: Fiscal Over-performance Relative to the EDP and Unexpected Non-tax Gains

Non-tax Revenues in Context

It is also useful to put Irish non-tax revenue data in context. We can do this by considering trends in broader GG revenues across countries. In Figure 7, we show the share of overall GG revenue accounted for by non-tax revenues in

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10 The bank guarantee or the Eligible Liabilities Guarantee (ELG) scheme was introduced in 2009 and ran until 2013. It provided an unconditional State guarantee for certain eligible liabilities (including deposits) of up to five years in maturity incurred by institutions participating in the Scheme.

11 The GG debt ratio increased from 43 per cent of GDP in 2008 to 123 per cent in 2013.

12 ELA was provided to the banking system from 2009 to 2013. Interest earned on ELA rose from €0.2 billion in 2009 to a peak of €1.6 billion in 2010 before declining to zero in 2014.

13 The liquidation of IBRC and subsequent restructuring significantly altered the composition of the Central Bank balance sheet. The composition of assets changed, as ELA (amounting to €39.5 billion) was eliminated and replaced primarily with a portfolio of long-dated Irish Government bonds and short-dated NAMA bonds. These amounted to €25.0 billion in Government floating rate notes, €13.7 billion in Government guaranteed NAMA bonds, a €3.5 billion Irish 2025 Government Bond and some additional collateral of €0.4 billion.

14 In 2014, local government receipts of €520 million were included in non-tax revenues. This is excluded from both Figure 6 and Table 1 as this is not considered to be an unexpected gain. It can be viewed as a transfer from one part of government to another.

15 We classify GG investment income (predominantly dividend and interest income) as non-tax revenue.
Ireland and in the Euro Area. This is further illustrated in Figure 8 where we plot non-tax revenues across a range of countries in both pre-crisis 2007 and as of end-2014. Both figures highlight the increasingly important role played by non-tax revenues in Ireland both in an absolute sense and also relative to the EU. Looking ahead, income from non-tax related sources is expected to decline as the effects of the financial crisis dissipate. The most recent draft Stability Programme Update (April 2015) projected that non-tax revenues will decline from a peak of €3.4 billion in 2015 to €2.1 billion in 2020. Managing the transition to lower and more 'normal' non-tax revenue levels will be challenging.

4 Conclusion

The past decade has highlighted the susceptibility of the economy to shocks and the importance of relying on more stable sources of revenue.

With this in mind, two recent trends in government revenue developments were discussed in this letter. On the taxation side there has been a strong recovery in income tax, which now represents around 40 per cent of tax revenue, up from just 26 per cent in 2007. Relying on solid, stable sources of tax revenue — rather than more cyclically sensitive sources — is desirable from a public finance perspective as it reduces a key vulnerability that developed in Ireland in the mid-2000s. Accordingly taking measures that reverse such trends would require careful consideration.

On the non-tax revenue side there has been a fourfold increase in inflows since 2007, partly due to the assistance the Government has provided to the financial sector. Given that this process added significantly to the stock of public debt there would appear to be a strong case that any 'unexpected gains' from these sources be used to exclusively reduce debt.
Similar arguments could be made in relation to any future income receipts arising from either the IBRC related Special Portfolio and the expanded Asset Purchase Programme. The overall stock of government debt remains high and needs to be reduced to safer levels. Actions that reduce public debt would also create more fiscal space in the event of a future negative economic shock.

Table 1: Non-Tax Revenues: Outturn less Budget Day Expectations

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<td>Budget Day</td>
<td>565</td>
<td>684</td>
<td>726</td>
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<td>1,970</td>
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<td>847</td>
<td>838</td>
<td>2,687</td>
<td>2,774</td>
<td>2,819</td>
<td>2,676</td>
<td>2,446*</td>
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| Outturn less Expectation | 73  | 163 | 112 | 332 | 804 | 324 | 316 | 466 |
| Outturn less             | 11.4| 19.2| 13.3| 12.4| 29.0| 11.5| 11.8| 19.0 |
| Expectation, %           |      |      |      |      |      |      |      |      |

Note: The Budget day expectation refers to the year-ahead projection for Exchequer non-tax revenues from successive Budgets. For example, Budget 2014 (published in October 2013) projected that non-tax revenues would be €1,980 million in 2014. *Receipts from local government into non-tax revenues in 2014 are excluded.

References


