Chapter 37

# Government Revenue and Expenditure

## Learning outcomes

**When you have completed this chapter you will be able to:**

- ✔ Explain the need for a national budget
- ✔ Identify sources of government revenue and items of government expenditure
- ✔ Distinguish between balanced, surplus and deficit budgets
- ✔ Outline the impact of budget decisions on Irish society.

## The national budget

The role of the government is to run the country. Providing public services is an important part of this task. Ireland has a **mixed economy**, which means that some goods and services are provided by the private sector while the government (or public sector) provides many others.

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The government will need to make use of available **resources** to provide the best possible level of public services. Since the government doesn't have enough resources to meet all demands for public services, it will need to *prioritise* some services over others. This requires the government to make *choices* which will have both financial and opportunity costs.

For example, if the government chooses to spend €200 million on a new hospital, this money is not available for spending on schools, roads or museums. Those schools, roads and museums which cannot now be built represent the opportunity cost of building the hospital.

See Chapter 1

Before making these kinds of choices the government will need to consider the revenue (or income) available to it.

## Government revenue

**Definition**

**Government revenue** refers to all money received by the government.

Government revenue can be divided into two distinct categories:

- **Current revenue** – money received by the government on a regular or day-to-day basis. The vast majority of this income comes from taxation.
- **Capital revenue** – money received on an irregular or once-off basis.

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## Major sources of government current revenue

- **Income tax:** Taxes on wages and salaries.
- **Universal Social Charge (USC):** Another tax on income.
- **Pay Related Social Insurance (PRSI):** Insurance paid by employers and employees, which is used to fund social welfare payments, such as illness benefit and maternity benefit.
- **Value added tax:** Tax on the value added to goods at each stage of their production. The burden of this tax falls on the consumers who buy the finished goods.
- **Corporation tax:** Tax on company profits.
- **Excise duty:** Tax charged on goods such as alcohol, tobacco and fuel products.
- **Customs duties:** A tax on goods coming into Ireland from countries outside the EU.
- **Local property tax:** Tax on residential properties.
- **Central Bank surplus income:** The role of the Central Bank is to manage the nation's money supply and to act as a 'lender of last resort' to banks during a financial crisis. If the Central Bank makes a profit on its operations, this money will be transferred to the government.
- **Capital gains tax (CGT):** Tax on the profits earned from investments. These profits usually arise from an increase in the value of shares or investment properties.
- **Capital acquisitions tax (CAT):** Tax on gifts and inheritances.
- **Dividends from State companies:** As the sole or major shareholder, the State is entitled to receive a share of any profits earned by State companies such as the ESB and An Post.
- **Stamp duty:** A tax for registering legal documents.

See Chapter 12

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**37.1** The table gives the government's budgeted figures for income in 2016.

**(a)** Calculate the percentage of overall revenue that each of the sources in the table represents.

**(b)** Create a pie chart or bar chart from this data.

**(c)** Do any of these figures surprise you? Comment on the figures.

**(d)** In pairs, create an infographic to display these figures.

| Revenue source | Amount of revenue €m |
|---|---|
| Income taxes (including USC) | 18,994 |
| Value added tax (VAT) | 12,860 |
| PRSI | 8,491 |
| Corporation tax | 6,614 |
| Excise duties | 5,643 |
| Stamp duties | 1,320 |
| Central Bank surplus income | 983 |
| Capital gains tax (CGT) | 589 |
| Local property tax | 438 |
| Capital acquisitions tax (CAT) | 375 |
| Customs duties | 391 |
| Dividends | 263 |
| National Lottery surplus | 203 |
| Other sources | 3,599 |
| **Total planned revenue** | **60,763** |

## Major sources of government capital revenue:

- **Sale of State-owned companies:** For example, in 2015 the government sold its 25% stake in Aer Lingus to the IAG group for €335 million.


- **Borrowings:** Our government borrows money from other governments or from financial institutions in order to fund its spending plans.
- **European Union (EU) grants:** The Irish government receives billions of euro from a variety of EU funding schemes. This money is used to support important economic and social projects.

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## Government expenditure

**Government expenditure** refers to all money spent by the government.

Definition

Government expenditure can be divided into two categories:

- **Current expenditure:** money spent by the government on a regular or ongoing basis. The majority of government current expenditure involves the day-to-day provision of essential public services. Operating costs and wages for public sector workers account for a large portion of government current expenditure.
- **Capital expenditure:** spending on 'once-off' projects or on infrastructure that will have long-term benefits for the country.

**Infrastructure** refers to the basic facilities, structures and services needed for a country to function. It includes water, power lines, transport, communications systems, schools and hospitals.

Definition

### Examples of government current expenditure

- **Social protection:** Payments and income supports such as pensions, child benefits and jobseekers' benefits.
- **Healthcare:** Expenditure on the day-to-day running costs of hospitals and healthcare facilities, e.g. staff wages, buying medicines, and light and heat.
- **Education:** Expenditure to enable schools and colleges to be run efficiently, e.g. teachers' salaries, light and heat, and maintenance of school buildings.

- **Justice:** Expenditure to ensure our legal and judicial systems operate, e.g. judges' wages, garda wages and operating costs of prisons.
- **Agriculture:** Expenditure to help farmers and ensure this important sector is maintained, e.g. income supports to farmers and funding for a wide variety of rural development schemes.
- **Defence:** Expenditure to maintain defence of our country, e.g. wages to members of the defence forces and civilians working for the sector, maintenance of facilities, training costs, etc.
- **Transport and tourism:** Money spent on maintaining our existing transport systems as well as providing funding for tourism promotion agencies such as Fáilte Ireland.

## Examples of government capital expenditure

- **Public transport:** Building new rail networks, buying new trains and buses.
- **Health:** Building new hospitals, buying new equipment and ambulances.
- **Education:** Building or extending schools, buying furniture and ICT equipment for schools.

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**37.2** The table gives the government's budgeted figures for expenditure in 2016 (with the department names correct at the time of the budget).

**(a)** Calculate the percentage of overall expenditure that each of the amounts in the table represents.

**(b)** Create a pie chart or bar chart from this data.

**(c)** Do any of these figures surprise you? Comment on the figures.

**(d)** In pairs, create an infographic to display these figures.

| Expenditure | Amount spent €m |
|---|---:|
| Social Protection | 19,627 |
| Health | 13,175 |
| Education & Skills | 8,524 |
| Justice & Equality | 2,264 |
| Agriculture, Food & the Marine | 1,134 |
| Children & Youth Affairs | 1,113 |
| Environment, Community & Local Government | 957 |
| Public Expenditure & Reform | 940 |
| Defence | 837 |
| Transport & Tourism | 722 |
| Foreign Affairs & Trade | 694 |
| Finance | 430 |
| Communications, Energy & Natural Resources | 325 |
| Jobs, Enterprise & Innovation | 297 |
| Art, Heritage & the Gaeltacht | 234 |
| Taoiseach | 201 |
| **Total planned expenditure** | **51,474** |

## Preparing a national budget

The **national budget** is the government's financial plan for the year ahead.

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The **Department of Finance** and the **Department of Public Expenditure and Reform** work together to ensure that the government has enough money to run the country. Each year the government must make a financial plan for the year ahead. It estimates how much money each government department will need in order to provide its services. It must also decide how to raise the income required to pay for these services. (See the tables in activities 37.1 and 37.2.)

The Department of Public Expenditure and Reform assesses each department's request for money and sanctions all government spending. The Department of Finance authorises all taxes and government borrowing.

Each year, the minister for finance outlines the government's financial plan for the coming year when the national budget is announced in the Dáil.

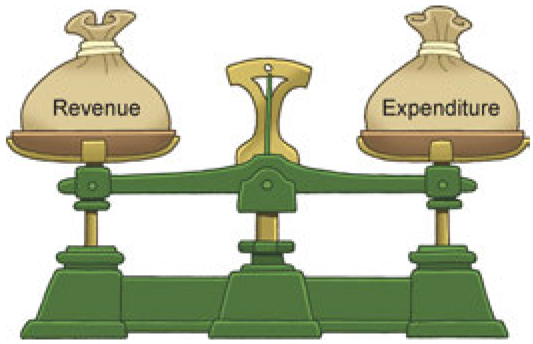
As with a household budget, the national budget sets out all the income that the government expects to receive. It also includes details of the government's spending plans.

## A balanced budget

If the government expects that planned revenue will be equal to planned expenditure it will be a **balanced budget**.

The following figures illustrate a balanced budget situation:

| | |
|---|---|
| Planned revenue (2019) | €52,876 million |
| Planned expenditure (2019) | €52,876 million |
| Balance | €0 |




In this situation the government is taking money out of the economy through taxation but is returning the same amount of money to the economy via spending on public services. For this reason a balanced budget is also called a **neutral budget**.

## A budget surplus

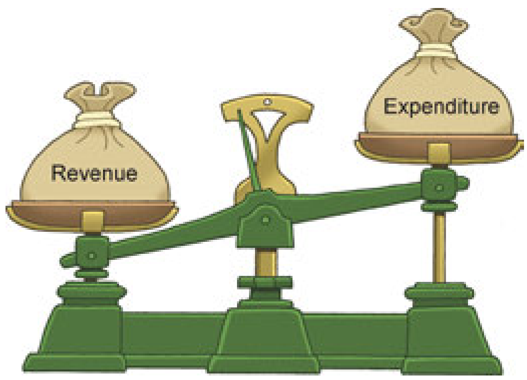
If revenue is expected to be *greater* than planned expenditure, the government will have a **budget surplus**.

Just as with household budgeting, a budget surplus indicates that the government is living within its means and has some scope to cut taxes or increase the level of services it plans to provide.

See Chapter 5

The following figures illustrate a budget surplus:

| | |
|---|---|
| Planned revenue (2019) | €52,876 million |
| Planned expenditure (2019) | €50,000 million |
| Budget surplus | €2,876 million |




In a surplus situation the government is taking more money out of the economy (through taxation) than it is putting back in (through spending). This will reduce the overall level of money and spending in the economy. Since it has the effect of making the economy smaller it is said to be a **contractionary budget**.

The government may choose to use this type of approach if it is concerned about inflation or the economy growing too quickly.

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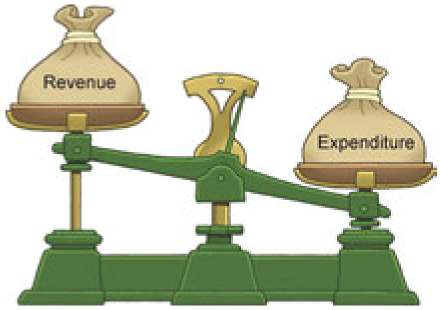
## A budget deficit

If planned revenue is *less* than planned expenditure, the government will be facing a **budget deficit**. This indicates that the government is living beyond its means and will have to increase taxes, cut spending or borrow money to finance its plans.

The following figures illustrate a budget deficit:

| | |
|---|---|
| Planned revenue (2019) | €52,876 million |
| Planned expenditure (2019) | €53,680 million |
| Budget deficit | (€804 million) |




A budget deficit is generally seen as a negative outcome and often arises because the government has failed to meet its income targets or because public expenditure is out of control.

As a member of the EU, Ireland must also follow strict financial rules that aim to control budget deficits. For these reasons the government will try to keep its budget deficits to a minimum.

**37.3** Look at the budget figures for 2016 in activities 37.1 and 37.2. Did the government expect to have a budget surplus, a balanced budget or a budget deficit in that year? Illustrate and explain your answer.

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Figure 37.1 illustrates the pattern of budget surpluses and deficits in Ireland during a ten-year period (2006–2015).

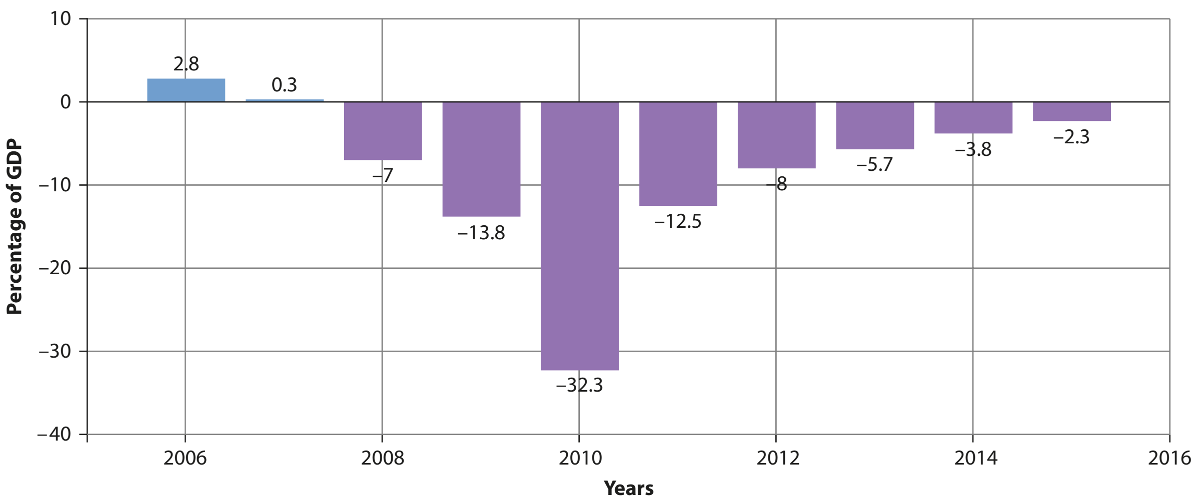


**Figure 37.1** Ireland's budgets 2006–2015

**37.4** In your group, discuss/comment on the trends and suggest possible reasons for them.

**37.5** How does the figure you calculated for 2016 follow the trends you identified in activity 37.4?

Groupwork

Discussion

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In some circumstances, having a budget deficit, especially a small one, may be a deliberate and positive economic policy choice by the government.

See Chapter 39

A deficit means the government is injecting more money into the economy (through spending) than it is taking out (through taxation). A deliberate decision to do this is known as an **expansionary budget** because it will result in extra money and spending in the economy. The government may use this approach if it wishes to boost the level of economic growth.

## Solutions to a budget deficit

There are three possible ways of reducing or eliminating a budget deficit and governments tend to use a combination of all three:

- **Increase planned revenue** – by raising taxation levels or selling state assets.
- **Reduce planned expenditure** – by cutting the level of public services.
- **Borrow money** – to bridge the gap between revenue and expenditure. This is a short-term solution since paying interest and repaying borrowings will impact on future budgets.

**37.6** Discuss why a government would use a combination of all three strategies to resolve a budget deficit.

Discussion

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### Key Terms

KSBL
KSC
KSMIT
KSBC

You should be able to *define*, *spell*, give *examples* and *apply* to real life each of the following key terms associated with this topic.

**Exercise:** Write a sentence using each of the following terms. You may use more than one of the terms in your sentence if appropriate.

| | |
|---|---|
| balanced budget | current revenue |
| budget deficit | Department of Finance |
| budget surplus | Department of Public Expenditure and Reform |
| capital expenditure | infrastructure |
| capital revenue | national budget |
| current expenditure | |