

The 1991 Budget

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The 1991 Budget may have been different in the sense that it was the first ever televised budget. However, there can be no doubt that it was another Albert Reynolds budget. It takes the same cautious, conservative approach to the economy as we have come to expect in recent years - a tinkering here and a slight adjustment there.

In this paper, the 1991 Budget is reviewed. Section one sets the stage, outlining the environment in which the Budget was written. Section two analyses the principal adjustments which were made. Finally, in section three, the probable impact of these changes on the main macroeconomic variables is assessed.

The environment

The international environment was certainly not conducive to an agreeable budget. In Britain, some commentators have warned of a possible 30's style depression if money is not pumped into the economy soon. The Chancellor has heeded this advice, and is now cutting the Base Rate whenever Sterling's position within the European Monetary System permits. The Chancellor also appears to be easing up on fiscal policy, as predictions of a PSBR of £8 - £10bn are forthcoming. The United States - another major export market for Ireland - is also enduring a recession, albeit a shallow one. The government continues to struggle with its huge trade and budget deficits, problems compounded by the \$500 billion bill which the Federal Deposit Insurance Corporation is facing following

the savings and loan debacle. The effects of this recessionary environment are clearly manifested in Ireland in the decisions of computers and electronics companies - such as Digital - to begin to introduce redundancies and short-time working.

Having said this, the German economy remains robust, and Irish exporters continue to benefit from this. Germany is a doubled edged sword, though. The governments decision not to raise taxes to finance reunification has put upward pressure on Irish interest rates.

Investment had been badly hit by the outbreak of war in the Gulf. Decisions were postponed until the international political climate stabilizes. At the time at which the Budget was presented, the outcome of the war was uncertain. Since then, with the culmination of the crisis, many sighs of relief have been breathed. However, it is likely that uncertainty will remain prevalent for some time to come.

This hostile international environment has been matched by growing domestic fiscal strains. As a result of the coalition agreement between the Progressive Democrats and Fianna Fail, the government is committed to income tax rates of 25% and 48% by 1993. On the horizon, the cost to the Exchequer of EC harmonization of VAT and excise rates could be in the region of £600m. Public sector pay will rise by 8.3% as a result of the Programme for National Recovery, and its successor, the Programme for Economic and Social Progress (PESP) will also strain the public purse because of commitments to increase

education, health and social welfare spending.

This then was the harsh environment in which the 1991 Budget was framed. The next section analyses the nature and scope of the package which Mr. Reynolds announced.

The 1991 budget

Most of the post-budget controversy centered around a single figure - the Department of Finance forecast of real GNP growth for the year 1991 of 2.25%. Although this is in line with the forecasts of the ESRI and the Central Bank, it is far

now implausible to suggest that, for fiscal 1991, real GNP growth could range anywhere between 1% and 3%.

Taxation and revenue

The likely tax revenues for the year depend fundamentally on this figure. The opening position was that tax revenue would increase by £482m to £8358m. In the Budget, the top rate of income tax was cut by one point to 52% and the standard rate also by one point to 29%. The ceiling on the health levy was removed which actually meant that the marginal rate for those on incomes above £16,700 actually rose from

GROWTH FORECASTS IN ECONOMIC AGGREGATES - 1991

%Volume Change	Davy	Goodbody	Central Bank	ESRI	Dept. Finance
Cons. Expenditure	2.5	2.6	2.75	2.75	3.25
Investment	1.5	1.0	5.00	4.25	5.50
Government	1.0	1.0	0.00	0.50	0.75
Exports	5.8	5.8	6.00	5.75	5.50
Imports	4.5	5.0	4.75	4.75	5.50
GDP	2.0	2.0	2.25	2.50	2.25
GNP	1.5	1.6	2.25	2.25	2.25

Sources:

- (i) *Irish Times*, issue dated 31 January 1991
 - (ii) *Davy's Stockbrokers: Budget 1991*
 - (iii) *Goodbody Stockbrokers: Budget Special 1991*
 - (iv) *Riada Stockbrokers: Riada Budget 1991*
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more optimistic than any independent commentator's forecast, as is clear from Table I. Because of its capacity to fluctuate widely, investment is perhaps the key variable. For example, an agreeable post-crisis level could revive Aer Lingus's plans to invest in the Dublin - Shannon - Los Angeles route. In addition, the construction industry may benefit from any contract work to be done in post-war Kuwait, but this is uncertain. These possibilities were not taken account of in the Budget. It is not

53% to 53.25%. Life assurance relief was halved from 50 to 25% of the premium. The total cost of these measures was estimated at £61.7m.

On the indirect taxation front, the 23% VAT rate was reduced to 21%, but the 10% rate rose to 12.5% (except for hotel accommodation; car, boat and caravan hire; newspapers; and construction; to which the 10% rate will still apply). The cost of these changes was estimated to be £31.7m. The excise tax on cigarettes was increased by

EXCHEQUER REVENUE (£m)	1990	1991 (opening)	1991 (post-budget)
Customs	114	125	125
Excise	1674	1725	1750
Capital	71	73	87
Stamp Duty	271	235	271
Income	3024	3279	3184
Corporation	474	527	527
VAT	1979	2112	2090
Agricultural Levies	10	11	11
Road Tax	160	164	179
Employment Levy	125	134	134
TOTAL TAX REVENUE	7903	8385	8358
Non Tax Revenue	366	403	416
TOTAL REVENUE	8269	8788	8774
% of GNP	36.6	36.9	36.8

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10 pence, projected to yield £21m, but the other "reliables" went untouched.

Road tax was increased for the first time in five years by 10%, which is expected to yield £14.7m. The Bank Levy and the PRSI allowance were both renewed (both measures cancel in cost terms). Finally, worthy of note was the effective abandonment of the Business Expansion Scheme. This follows the Comptroller's and Auditor-General's damning indictment of the scheme towards the end of last year. This measure provoked harsh criticism from the both the tourism and shipping sectors.

Expenditure

The government had forecast that expenditure would increase by £465m to £8986m in the White Paper on Receipts

and Expenditure. In the budget proper, the Minister increased this estimate by £33m, with the bulk of this being allocated to health, social welfare and education in line with the Programme for Economic and Social Progress. The Minister made no change in the Budget to the Central Fund allocation of £2797m.

Current spending is expected to total £9019m for fiscal 1991. Perhaps the most welcome but derisory alteration was an increase in the allocation to the Family Income Supplement Scheme of £1m. This measure will do nothing to alleviate the effects of the poverty trap.

The effects

The short term

Broadly speaking, the Budget was positively received by the financial markets (*The Irish Times*, 1991). Attention focussed on projected Exchequer Borrowing Requirement of £460m, which was below market forecasts of between £500 and £700m. It is worth noting that the achievement of such a low EBR is contingent on the realization of the Departments forecast growth rate of 2.25%.

The Budget in isolation will put downward pressure on interest rates which will give the economy a much needed boost. With small savings of £100m and a reduction in Exchequer balances of £60m, the Minister may require as little as £300m

from the markets over the year. Some dealers have speculated that long bond yields will fall by 1%, and that Irish Equities will be priced upwards (Riada Budget, 1991).

The effect on the economy can only be described as marginally expansionary. The minimal reductions in income tax and the reduction in VAT will only increase real disposable incomes slightly, and certainly not by the same magnitude as was the case in recent years. The changes in indirect taxation are not expected to impact significantly on inflation, since reduction in the prices of luxury items will be offset by the increased costs of fuel and heating.

EXCHEQUER EXPENDITURE (£m)	1990	1991 (opening)	1991 (post-budget)
Interest	2108	2194	2194
EC Contribution	284	367	367
Total Central Fund	2604	2797	2797
Pay	3161	3419	3422
Non-Pay	2656	2770	2800
Total Supply Services	5817	6189	6222
Total Current Spending	8421	8986	9019
Less Total Revenue	8269	8788	8774
Current Budget Deficit	152	198	245
% of GNP	0.7	0.8	1.0
Plus Capital Borrowing	310	214	215
EBR	462	412	460
% of GNP	2.0	1.7	1.9

Sources:

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In this light, inflation is expected to average 3.0% for the year. The changes in income tax and the Family Income Supplement in themselves were so slight that the Budget will do nothing to create employment, which is therefore likely to increase throughout 1991.

The medium term

The nature of the Budget raises questions about the strength of the government's commitment not to return to the vices of the early eighties. This point is born out by the fact that last year's EBR would have been £360m, and this year's target would be £562m, had the 1990 Structural and Regional Development Fund payments arrived from Brussels on schedule. The Minister, however, can contend with some justification, that, given the uncertain backdrop against which the Budget was framed, any fiscal innovations could possibly have proved counter-productive.

In the next few years, the government will have to face huge bills for its economic policy. VAT reductions in the run up to 1992 combined with the reductions in tax rates embodied in the PESP will impact severely on revenues. This means that in 1992/3 there will be a need for further fiscal adjustment. A necessary condition for such adjustment will be continued consensus between the social partners and the success of the PESP. A return to full prosperity by the global economy would greatly facilitate this.

One aspect of fiscal reform which deserves more attention is the introduction of a property tax. Such a tax would yield significant amounts of revenue (estimates suggest £400 - £500M in the first year, and up to £600M thereafter) while at the same time substantially widening the tax base. However, given the political sensitivity of this issue, it is unlikely that such a tax would be introduced in the current Zeitgeist.

Conclusion

This essay has looked at the 1991 Budget. Both the backdrop to the Budget and the adjustments which it contained were discussed. In addition, a prognosis for the economy, in the light of these changes, was sketched.

It is possible that, unless significant fiscal reforms are implemented in the medium term, a return to the misery of the early and mid-1980s will occur.

References

- The Irish Times* (1991) Issue dated 31 January.
 Riada Stockbrokers (1991) *Riada Budget*.
 Dublin.