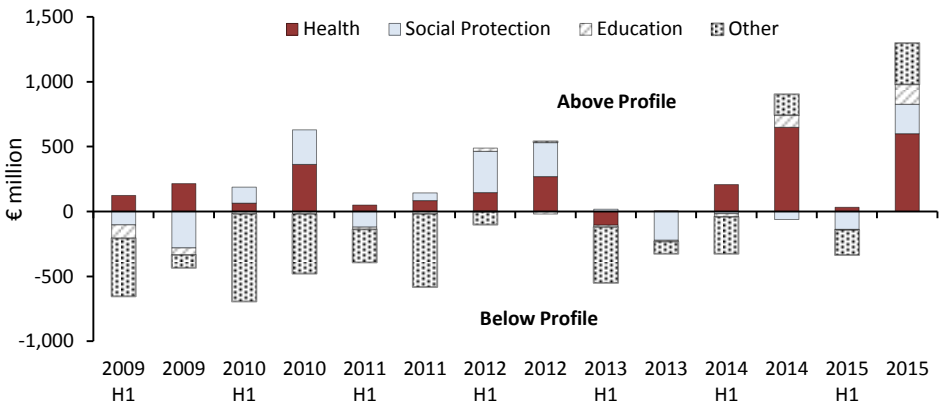
Box C: Health Expenditure in 2015 and Implications for Future Expenditure Ceilings

The Council have previously drawn attention to the issue of spending on public health exceeding planned levels (IFAC, 2015). Until 2013, overruns in this area were largely offset at the aggregate level by below budget spending by other Departments (Figure C.1). However, in 2014 and 2015 net spending by all Departments exceeded the budgeted allocations by €0.8 and €1.3 billion.[1] The largest single source of these Exchequer overruns was the Health area, accounting for €647 million (77 per cent) in 2014 and a planned €600 (46 per cent) in 2015.[2]

Figure C.1 Cumulative Overruns in Exchequer Expenditure: Mid-Year Vs End-Year



Source: Department of Finance, *Monthly Exchequer Returns.*
Note: These figures show Exchequer (net) Departmental expenditure as reported in the monthly Exchequer Returns. As gross expenditure has only been reported on a monthly basis since 2013 net expenditure provides a series for comparison.

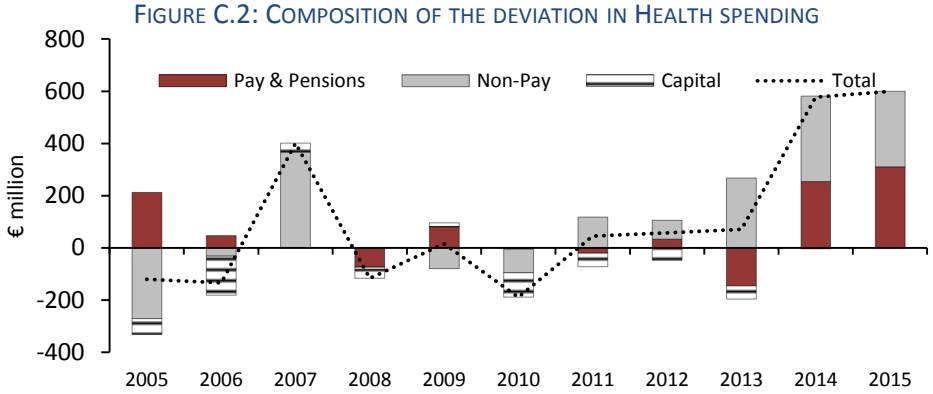
For both 2014 and 2015, the overrun is divided broadly evenly between pay and non-pay expenditure, with pensions running slightly ahead of budget and capital spending on target (Figure C.2). Given that over 70 per cent of spending is in the hospitals area, this would indicate that much of the pay issue arises in this area. On the basis of the 2015 forecast outturns, health represents 99 per cent of the total Departmental pay overrun, but only 28 per cent of the non-pay. This seems to indicate specific problems with the Department of Health's pay budget that have not been resolved through the change in 2015 from a system of limits on staffing levels (the Employment Control Framework) to

[1] The gross expenditure figure reflects expenditure by Departments and offices regardless of the source of funding. Exchequer expenditure, or net expenditure, is net of receipts received directly by Departments including the pension-related deduction, certain EU co-funding payments and pension contributions. It also excludes expenditure by the Social Insurance Fund and the National Training Fund financed through the 'own income' of the funds. The difference in 2014 is mainly accounted for by higher than expected PRSI receipts that reduce the Exchequer cost. Gross spending has only been reported on a monthly basis since July 2013.

[2] While the higher than budgeted spending among Departments may, to some extent, represent a policy decision reflecting the position relative to fiscal rules in 2015, it seems unlikely that significant savings will arise across Departments in future given the impact of a reduced base on permitted expenditure the following year (see Section 4.4).

Departmental pay ceilings. These problems may arise from difficulties in implementing pay related reforms leading to higher average pay than expected, larger than planned staffing or a combination of both.

FIGURE C.2: COMPOSITION OF THE DEVIATION IN HEALTH SPENDING



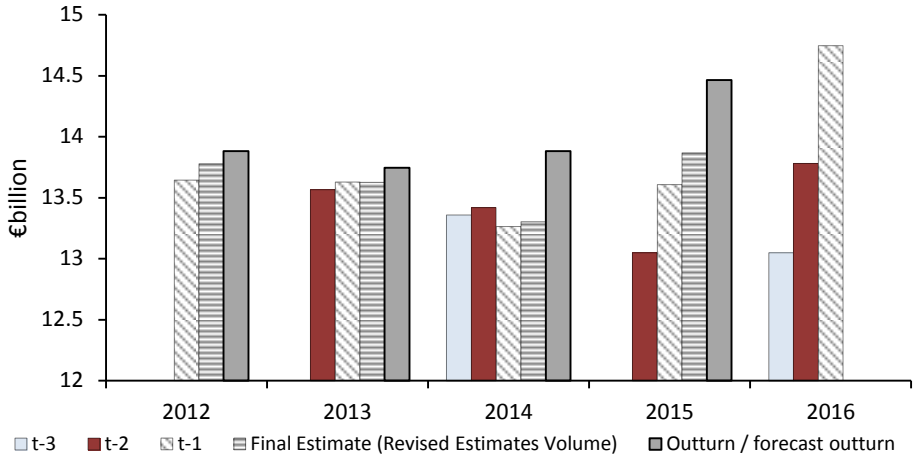
Source: Department of Public Expenditure and Reform databank and Revised Estimates for Public Services, various years.
Note: The deviation in health spending including both the Department of Health and the HSE. This may somewhat understate the extent of overruns as the Department of Health typically spends less than its budget allocation.

The majority of over-spending in recent years arose mainly in the hospitals and Primary Care Reimbursement Service (PCRS) areas. The latest HSE Monthly Performance Report for end-August shows that the largest deviations are again in these areas: a €122 million overrun in the hospitals area and €68 million in PCRS. The State Claims Agency, which is also under the remit of the HSE, was also running significantly ahead of profile by €61 million.

The potential negative feedback between poor budget setting and poor expenditure management now appears particularly marked in the health area, with expenditure overruns leading to significant upward revisions to future multi-annual ceilings.[3] In 2015, a €0.6 billion overrun is expected despite an upward revision of €0.8 billion from the initial ceiling for 2015 in *Expenditure Report 2014* (see Figure C.3). A continuation of this trend into 2016 would have implications for planning and managing expenditure within the budgetary framework.

[3] In relation to budget implementation, IFAC (2015) identified the 'soft budget constraint' (SBC) as a possible structural difficulty in managing health expenditure within the budget year. This theory posits that, notwithstanding *ex ante* threats to impose a hard constraint, the budget constraint is soft where the decision maker in control of day-to-day expenditure anticipates that the constraint is likely to be relaxed *ex post* if the original constraint is not met. Where the budget setting process is weak, this may further 'soften' the constraint as the manager – knowing plans are poorly set – has less of an incentive to adhere to them. The existence of a SBC may also weaken the budget planning process where budget allocations have been persistently exceeded in the past and led to ambitious targets being set.

Figure C.3 Evolution of Health Multi-annual ceilings



Source: Comprehensive Expenditure Reports and Expenditure Reports, 2012 to 2016*,* Department of Public Expenditure and Reform *databank and Revised Estimates for Public Services* 2012 to 2015*.*
Note: The outturn figure for 2015 is the forecast outturn reported in *Budget 2016*. The ceilings and outturn from 2014 are adjusted for comparison puposes to reflect changes in the structure of Health spending that do not reflect changes in the actual level of expenditure. The Revised Estimates and outturn figures for 2014 and all subsequent figures are adjusted for the transfer of funding to the Department of Children and Youth Affairs. The Revised Estimates and outturn figures for 2015 and all subsequent figures are adjusted for the move to a net grant approach for the HSE arising from the merging of the HSE Vote into the Department of Health Vote in 2015.