Box D: Health Overruns

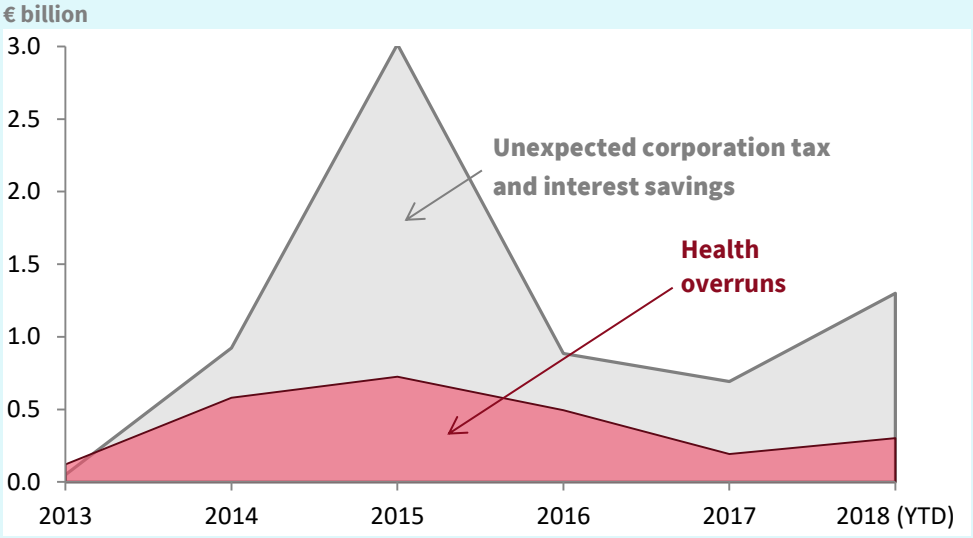
In recent years, there has been a persistent pattern of large overruns in health spending. A combination of unrealistic forecasts and repeated relaxation of ceilings have repeatedly led to uncontrolled increases in spending, which can put the public finances at risk. Over the period 2014–2017, these overruns have averaged €0.5 billion per year (in current spending terms). In 2018, the Government expects a health spending overrun of €0.6 billion, one of the largest overspends in recent years.[1] This implies that the 2018 outturn is now expected to be 9.3 per cent higher than the ceiling set in the previous Budget. In light of previous experience, the *Budget 2019* forecasts for 2019–2021 may not be realistic.[2]

This box highlights important issues with health overruns, namely: (i) the way these long-lasting increases in expenditure have been generally absorbed by unexpected, transient gains from the cycle; (ii) the budgetary implications of spending peaks taking place late in the year; and (iii) the underlying deficiencies that are driving this pattern of large overruns.

Long-lasting health pressures are being masked by temporary gains

Since 2013, the impact of health overruns on the deficit has been masked by unexpected gains from corporation tax and interest savings, both of which may well be temporary. Figure D.1 shows that, in 2013–2017, the current health overspends (averaging €0.4 billion per annum) were outweighed by unexpected corporation tax receipts (averaging €0.8 billion) and unexpected interest savings (averaging €0.3 billion).

Figure D.1: Health Overruns Masked by Unexpected Corporation Tax and Interest



Sources: Department of Finance, Analytical Exchequer Statements; and internal IFAC calculations.
Note: Overruns are shown in gross voted current spending terms. All figures are derived from the end-December Analytical Exchequer Statements outturns less profiles. 2018 shows data to end-October.

[1] The expected total overrun for 2018 is €0.7 billion, of which €0.6 billion relates to current spending, and the remaining €0.1 billion relates to capital expenditure and a shortfall in Departmental receipts.

[2] For 2019, the current health ceiling is forecast to growth by 5.8 per cent. For 2020–2021, current health spending is forecast to grow by less than 1.0 per each year, which appears too modest compared with the trends in the last years.

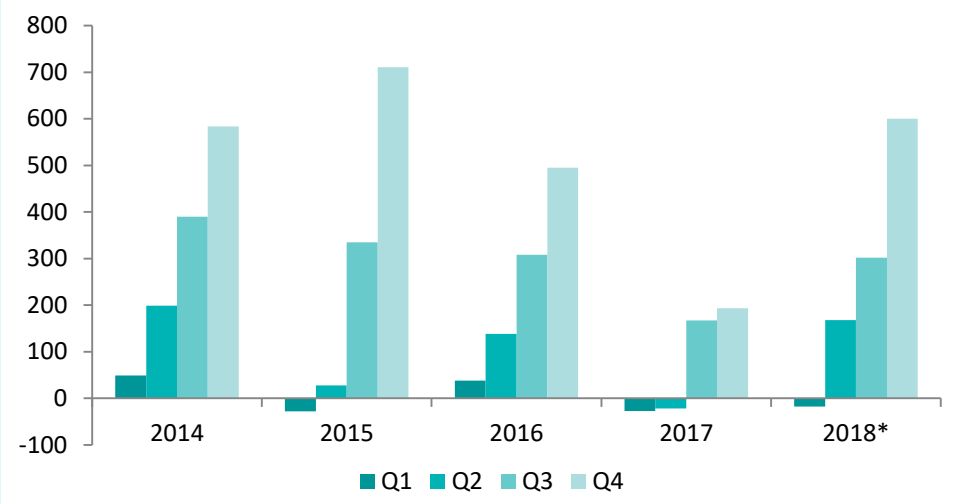
The volatility and strong concentration of corporation tax in Ireland—where the top 10 companies account for roughly 40 per cent of all corporation tax receipts—implies that unexpected revenues from this source should be deemed as transient.[3] Similarly, unanticipated interest savings over the last years are a result of changes in the external environment, which may prove temporary in nature.

To the extent that gains are temporary or cyclical, these should not be used to mask ongoing health overruns. Doing so risks a repeat of the pro-cyclical policy mistakes of the past. Instead, pressures in the health sector should be absorbed through sustainable tax revenues or decreases in spending categories elsewhere.

Overruns late in the year imply higher carryover costs

Recent trends have shown health spending ramping up in the second half of the year, especially in the last quarter (Figure D.2). This is the case, yet again, in 2018, when half of the expected current spending overrun in 2018 is to take place just in the last quarter.[4] However, it is worth noting that the later the overrun occurs within the year, the less time there is to adjust spending in the remainder of the year. This also triggers larger spending carryovers in the following year.

Figure D.2: Health Overspends Tend to Ramp Up Late in the Year
€ million (cumulative), per quarter



Sources: Department of Finance Analytical Exchequer Statements; and internal IFAC calculations.
Note: Overruns are shown in terms of gross voted current spending and are derived from the monthly Analytical Exchequer Statements outturns less profiles. * The 2018 figure for Q4 is an IFAC estimate.

A key driver of this pattern in the timing of overspends is related to staff recruitment. As noted in Connors (2018a), recruitment in each of the last quarters of 2015–2017 by the Health Service

[3] The June 2018 *Fiscal Assessment Report* (IFAC, 2018c) provided a stylised scenario on the direct impact of a large firm leaving Ireland. This exit was estimated to trigger a reduction of government revenues by over €330 million, close to half a per cent of total revenue in 2016 (and higher than the current health overspend of 2017).

[4] While the first three quarters of 2018 have seen an overrun of €0.3 billion in current terms, the expected overrun for the last quarter is €0.3 billion.

Executive has averaged 1,432. This represents 40 per cent of the annual increase in employment over just a three-month period. As in previous years, an important part of the 2018 overrun is likely to be unplanned increases in staff.[5] As new recruits have commenced work at different stages in 2018, the full-year cost of employing them will only be realised in full in 2019. This means that the overrun will imply carryover costs into 2019, more so because of the late timing. The Department currently estimates that these carryover costs into 2019 will amount to €0.3 billion, implying a €1.1 billion full-year cost of the overruns this year.

These timing effects, if not accounted for properly, can have important implications. For example, the 2018 carryover costs narrow the budgetary resources available for 2019. This is partly reflected in the increased ceiling forecast for 2019 since July's *Mid-Year Expenditure Report 2018* (estimated at €15.0 billion) relative to the latest ceiling established in *Budget 2019* (€16.4 billion, in gross current terms). This implies a revision in the ceiling of €1.4 billion for next year in just three months.

Health budgets should be well-founded and credible

The budget overruns in recent years largely reflect significant deficiencies in health spending management, including:

1. **Weak planning**: spending plans are not accurately accounting for increasing cost pressures and demand for health services; and
2. **Weak spending controls:** day-to-day health spending is not sufficiently constrained throughout the year.

The combination of weak planning and weak spending controls has led to a "soft budget constraint" problem. That is, providers of health services anticipate that yearly spending ceilings will be relaxed at a later stage with little opposition, and this weakens the incentive to stay within initial spending targets (Howlin, 2015). When this happens persistently, it can lead to uncontrolled increases in spending and budget plans can lose credibility. If spending overruns are likely to be long-lasting (e.g., when permanent staff are unexpectedly recruited), but are funded by temporary revenues, the sustainability of public finances can be put at risk. When temporary revenues disappear, the long-lasting spending overruns will remain and will lead to deteriorations in the government balance, unless those costs are offset by new tax-raising measures or savings elsewhere.

[5] Connors (2018b) notes that the Health Service Executive is required to produce a Pay and Numbers Strategy every year including detailed information on the number of staff to be hired along the year. However, these reports have tended to be submitted very late in the year. For example, a revised version of the document for 2016 was submitted in December 2016, which looked to significantly increase the end-2016 staffing number. This was done despite not having the resources to undertake such increases. In 2017 and 2018, submissions took place in November and August, respectively.