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# The impact of the economic boom and bust on local government budgets in Ireland

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## Abstract

This paper analyses the effects of the economic crisis on local government budgets in Ireland. In this context, it also examines the preceding period, namely the impact of the economic boom on local government finances. We find that the budgets of local authorities, as with the national budget, increased greatly throughout the boom years. Although local authority spending increased, local governments were not as profligate as central government during this period. As for the economic recession, the evidence is of a lagged effect on local government budgets, with no dramatic change in 2008, unlike the impact at the central level. As with downturns elsewhere, the negative impact of this recession on local authority budgets began to impact only after it had affected the national budget. Falling local revenues combined with significant reductions in central government allocations to local government have resulted in expenditure adjustments as local authorities seek pay and non-pay savings. We also show evidence of much cross-council variation in finances, with particular regard to changes in rate income and central government grants.

*Keywords*: Local government, expenditure and revenue assignment, boom and bust

## Introduction

Much has been written about Ireland's recent economic crisis, in terms of both its causes and consequences (Kelly, 2010; Whelan, 2010). With regard to the latter, a lot of attention has been given to the impact of the economic downturn on the national budget and the subsequent fiscal crisis (Bergin et al., 2011; Lane, 2011). A large and sudden contraction in output resulted in a decline in tax revenues and an increase in spending on benefits arising from a big increase in unemployment. The purpose of this paper is to investigate the impact of the downturn (but also the economic boom that preceded it) on local government budgets, particularly in terms of revenue and expenditure patterns, own-source revenues and transfers from central to local government.

We begin with a brief synopsis of expenditure and revenue assignments, as they relate to Ireland. Following that, we look at the income and expenditure patterns of local government budgets during the period 2003–7, often described as the second stage of the Celtic tiger era. We then repeat this aggregated exercise, but for the period since 2007/8. A more disaggregated analysis at the level of city and county councils follows, focusing on changes in total revenue, rate income, grants, tax rates and tax bases. The paper ends with some general concluding remarks relating to the funding of local government in Ireland.

## Irish local government in context

### *Expenditure assignment*

Ireland's local government remit, relative to local government powers in other European countries, is quite narrow and limited. This is evident when subnational public sector expenditures are reported across EU countries. Relative to GDP or to total public spending, Ireland has one of the lowest shares, with only Greece (excluding the small nations of Cyprus and Malta) having a lower share. While the average subnational (current and capital) expenditure share across the EU-27 in 2010 was 13.7 per cent of GDP and 27 per cent of total public expenditure, the corresponding figures for Ireland were only 6.9 and 10.3 per cent, respectively (CEMR–Dexia, 2011).[1] Nevertheless, these amounts, although falling since the onset of the crisis, are not insignificant.

[1] Although we report the latest CEMR–Dexia data available, for 2010, we acknowledge that as the 2010 fiscal accounts for Ireland are distorted by the cost of the bank bailouts, the ratio of subnational public sector expenditure to total public sector expenditure, at 10.3 per cent in 2010, may be an underestimate of the measure of fiscal (and expenditure) decentralisation. In previous years, this ratio was 16 per cent or higher.

In terms of expenditure assignment, local authority services are classified, for accounting purposes, into eight functional or programme areas. A breakdown of current spending between the eight service divisions is given in Table 1.

**Table 1: Expenditure functions, 2012**

| *Service divisions* | *€m* | *%* |
|---|---|---|
| Housing & building | 771 | 17.7 |
| Road transportation & safety | 870 | 20.0 |
| Water services | 712 | 16.4 |
| Development management | 274 | 6.3 |
| Environmental services | 669 | 15.3 |
| Recreation & amenity | 372 | 8.5 |
| Agriculture, education, health & welfare | 244 | 5.6 |
| Miscellaneous services | 445 | 10.2 |
| Total expenditure | 4,356 | 100 |

*Source:* Local authority budgets, 2012.
*Note:* These are budgeted figures as, at the time of writing, the (audited) consolidated actual out-turns were only available up to 2010.

Given the relatively limited functions of subnational government in Ireland it is often said that local government tasks in Ireland are concerned primarily with the provision and maintenance of infrastructure and the physical environment. Many of the expenditure functions assigned to local government in Ireland involve services with subnational or, more specifically, local 'benefit areas' such as public lighting, fire service, litter prevention and recreational amenities such as swimming pools, parks and museums. On the other hand, expenditure functions allocated to central government, such as national defence, tertiary education and research, foreign relations and social protection, all have a more national dimension.[2] It is the remaining functions, especially those related to (primary and secondary) education and primary health services, that are currently the responsibility of central government but would generally be regarded as local services and, commonly, are competences of subnational governments in other countries.

[2] With respect to social welfare and protection, social housing is a local authority function. Although part of the redistributive function of government (and thus, it is argued, a competence of central government), the information advantages that local government has in providing social housing may warrant a role for subnational government.

***Revenue assignment***

With respect to the financing of public services, local government in Ireland is funded by a combination of central and local sources of income, including local business rates, charges and fees for goods and services, and transfers and grants from central government. The general purpose grant, financed by motor taxation receipts and an exchequer contribution (up to 2011), provides local authorities with the funding for general discretionary day-to-day activities. As for specific purpose grants, these are earmarked for certain activities, often undertaken on behalf of central government, and are paid annually to local authorities by certain central government departments. Commercial rates are levied on the occupiers of commercial property, with the rateable valuation of a property based on an estimate of the annual rental value of the property at a specified date. As it applies to commercial property, it can be viewed as a tax on business, or a form of property tax. Examples of charges and fees for goods and services include commercial water charges, housing rents, planning application fees, waste charges and parking fees. Although for many of these the charge is set locally, the actual goods/services that can be charged for are decided by central government. Prior to 2012/3 and the introduction of the household charge/local property tax (LPT), Ireland, with no local taxation on individuals or households, was unusual (indeed, almost unique in the EU) in that it did not have a residential property tax or residential/domestic water charges.

Table 2 outlines the sources of revenue for 2012.[3] Of course, the specific distribution of income from the different revenue sources varies between authorities and, in particular, between the more urban city councils (where economic activity is centred, resulting in a bigger commercial rates base and greater potential for revenue from charges/fees and local taxation) and the more rural county councils (with a limited economic base, resulting in a greater dependence on central government for income).

Taking the general purpose block grant and the specific purpose grants together, almost 40 per cent of funding for local government comes from central government, with just over 60 per cent locally funded. With respect to the problem of fiscal equivalence, the vertical

[3] In terms of the usual taxonomy of local government funding sources commonly used in cross-country comparisons, the income sources depicted in Table 2 can be simplified into three broad, universally used classifications, namely local taxation, central government transfers/grants and charges/fees for goods and services.

**Table 2: Local government revenue, 2012**

<table>
<tr><th>Sources of income</th><th>€m</th><th>%</th><th>%</th><th>Source</th></tr>
<tr><td>Charges/fees</td><td>1,180</td><td>27.2</td><td rowspan="2">60.9</td><td rowspan="2">Local</td></tr>
<tr><td>Commercial rates</td><td>1,461</td><td>33.7</td></tr>
<tr><td>Specific purpose grants</td><td>958</td><td>22.2</td><td rowspan="2">39.1</td><td rowspan="2">Central</td></tr>
<tr><td>General purpose grant</td><td>730</td><td>16.9</td></tr>
<tr><td>Total revenue</td><td>4,330</td><td>100</td><td>100</td><td></td></tr>
</table>

*Source:* Local authority budgets, 2012.
*Note:* These are budgeted figures as, at the time of writing, the (audited) consolidated actual out-turns were only available up to 2010. The total income excludes County Demand and Credit/Debit Balances. Inclusion of these gives the same €4,356 million amount as in the total budgeted expenditure of Table 1, as required of the local authorities in Ireland.

fiscal imbalance in the Irish local government system is due to the inadequate own-source revenues and funding available to local authorities (often due, it can be said, to understandable public and political resistance) to meet, what are generally considered to be, quite limited expenditure responsibilities. This has implications for the principle of accountability as responsibility for raising the necessary revenue (in the form of local taxes, for example) does not always reside with those who have responsibility for spending. This, it is often argued, hinders the ability of local governments to reflect the preferences of the electorates in particular areas.

As with expenditure, Ireland's subnational (tax) revenue share of GDP or of total (tax) revenue is relatively low. As a share of total tax revenue, local government tax revenue in Ireland was only 4 per cent in 2010, with (again, excluding the very small nation states of Cyprus and Malta) only Greece and Bulgaria having a lower tax revenue share in the EU-27, and the EU-27 average being 18 per cent (CEMR–Dexia, 2011).

In summary, Ireland is one of the most centralised states in Europe with local government having few responsibilities and lacking the commensurate resources. From an EU comparative perspective, local government in Ireland has fewer functions than elsewhere, is poorly funded, has limited discretion and powers, and, overall, is characterised by a high degree of centralisation. Despite periodic reviews of local government, with at least half a dozen in the past half century, Ireland's past record and current position on intergovernmental fiscal relations and fiscal decentralisation remain unremarkable.[4]

## Economic boom and local government budgets

During the second half of the Celtic tiger years, beginning in 2001/2, Ireland witnessed a well-documented rapid growth in incomes. The impacts on both central and local governments were substantial, as evident from the national and subnational government budgets. With respect to central government, as output, incomes and profits soared, so did tax revenue accruing from VAT, personal income tax and corporation tax. With regard to local government, as the number of commercial businesses and motor vehicles increased, so did tax revenue accruing from commercial rates and motor taxation. Moreover, an unprecedented expansion of the construction sector, in both residential and commercial production and sales, benefited both central and local government. Central government benefited from the property boom as a result of increases in tax revenue arising from capital gains tax (on disposal of properties), VAT (on building materials) and stamp duty (on transactions, especially on the purchase of houses and apartments). The benefits to local government came directly in terms of development levies (although not always paid) and indirectly in terms of an increase in transfers from central to local government.

As local government income increased throughout the 2003–7 period, so did local government expenditures (on the back, it must be said, of greater responsibilities). Spending on roads, water services, environmental services, planning and development, and housing increased. Tables 3 and 4 outline the (current) income and expenditure patterns for the five-year boom period 2003–7.

With regard to revenue income, the increase for the period 2003–7 was over 50 per cent, amounting to an annual average increase of almost 9 per cent, as against an annual average inflation rate for the same period of about 3.5 per cent. This 50 per cent increase was in line with the increase in the central government's current revenue over the same period. The increase recorded for local government expenditure, although not as large as the change in local government revenue, was

[4] As the *Commission on Taxation Report 2009* noted, when reporting on local government funding in Ireland, 'It is a policy issue that cannot be said to be understudied' (Commission on Taxation Group, 2009).

**Table 3: Local government revenue, 2003–7**

| | *2003 (€m)* | *2003* | *2004* | *2005* | *2006* | *2007* | *2003-07* |
|---|---|---|---|---|---|---|---|
| | | | | *(% change)* | | | |
| Total, of which | 3,408 | 8.5 | 10.2 | 6.6 | 11.2 | 8.0 | 53 |
| Charges/fees | 1,093 | 17.8 | 6.9 | 1.5 | 7.9 | 11.3 | 53 |
| Commercial rates | 841 | 12.0 | 12.2 | 11.4 | 13.3 | 6.5 | 69 |
| Specific purpose grants | 851 | –1.7 | 4.8 | 7.0 | 16.1 | 5.7 | 35 |
| General purpose grant | 624 | 5.2 | 20.5 | 8.6 | 7.3 | 8.2 | 60 |

*Source:* Department of the Environment, Community and Local Government; authors' calculations.
*Note:* The annual inflation rates for the years 2003–7 were 3.5, 2.2, 2.5, 4.0 and 4.9 per cent, respectively, amounting to an inflation rate of 18.2 per cent for the five-year period of 2003–7.

**Table 4: Local government expenditure, 2003–7**

| | *2003 (€m)* | *2003* | *2004* | *2005* | *2006* | *2007* | *2003-07* |
|---|---|---|---|---|---|---|---|
| | | | | *(% change)* | | | |
| Total, of which | 3,235 | 3.2 | 9.9 | 6.4 | 11.5 | 8.5 | 46 |
| Housing & building | 475 | –7.9 | 3.2 | 5.5 | 10.8 | 15.0 | 28 |
| Road transportation & safety | 932 | 1.6 | 7.6 | 4.7 | 14.4 | 5.0 | 38 |
| Water services | 382 | 10.4 | 15.7 | 8.6 | 18.5 | 13.5 | 87 |
| Development management | 168 | 8.4 | 19.0 | 5.0 | 6.2 | 12.6 | 62 |
| Environmental services | 598 | 5.7 | 9.5 | 8.5 | 6.8 | 4.9 | 41 |
| Recreation & amenities | 262 | 4.0 | 9.2 | 9.1 | 9.6 | 10.5 | 50 |
| Agriculture, education, health & welfare | 195 | 13.4 | 25.1 | 7.8 | 8.7 | 9.4 | 82 |
| Miscellaneous services | 224 | 5.7 | 4.5 | 3.0 | 10.0 | 3.0 | 29 |

*Source:* Department of the Environment, Community and Local Government; authors' calculations.
*Note:* The annual inflation rates for the years 2003–7 were 3.5, 2.2, 2.5, 4.0 and 4.9 per cent, respectively, amounting to an inflation rate of 18.2 per cent for the five-year period 2003–7.

also very sizeable (at 46 per cent). Interestingly, the increase in local government expenditure for 2003–7 was less than the increase in central government expenditure for the same period: about 10 percentage points lower. This suggests that local governments were not as profligate as central government during this boom period of the Celtic tiger era.

In terms of the composition of both local government revenue and expenditure, increases above the average were evident in local authority income from both commercial rates and the general purpose grant, and, on the expenditure side, in local authority spending on planning and development, and water services. Smaller increases – much less than the average – were reported for, on the income side, specific purpose grants and, on the expenditure side, spending on housing and building (as much of the housing boom was in the private sector as opposed to local authority and social housing).

As for differences between local authorities, and particularly in terms of the centrally funded general purpose grant and the locally determined commercial rates, we found evidence of sizeable differences between councils. For example, in terms of commercial rates levied by city and county councils, the increase in the ARV (Annual Rates on Valuation) for the five-year period was 28 per cent (with a steady decline over the period in the annual rate of increase, from 7.4 per cent in 2003 to 3.5 per cent in 2007), with larger increases in Galway, Kilkenny, Meath, Offaly and Roscommon County Councils as against much smaller increases, admittedly from initially high ARVs, in Dún Laoghaire–Rathdown County Council and Limerick City Council. By 2007, the lowest ARV was, as in 2002, in Kilkenny County Council, at 49.82, and the highest ARV was 75.90, in Kerry County Council.

In respect to the general purpose grant, whereas the total allocation from central to local government increased by 60 per cent during the period, the size of the increase in the allocation differed from council to council. More specifically, whereas Donegal, Kildare, Mayo, Offaly, Waterford and Westmeath County Councils and Dublin City Council all received increases in the Local Government Fund general purpose allocation of over 70 per cent, increases of only 50 per cent or less were reported for Cork, Dún Laoghaire–Rathdown, Fingal, Roscommon and South Dublin County Councils and Galway City Council. Taking population changes as a proxy for expenditure needs and the county income per capita as a proxy for resources and fiscal capacity, we found no evidence of a relationship between changes in these proxies (that is, population increases and income increases) and the changes reported above (that is, in the general purpose grant to city and county councils). Yet, in this period the computer-based needs and resources model, and the equalisation formula therein, was still being used by the central government's department to determine the general purpose allocation to the thirty-four city and county councils. It may simply be that our two proxies did not capture all the variables and norms used, and the changes therein recorded, in the needs and capacity assessment of local authorities. By the late 2000s the formula had been abandoned (possibly due to its complexity and data requirements), although equalisation transfers from central to local government continued.

In terms of the composition of revenue, the county councils were more dependent, relative to city councils, on central government grants, whereas the city councils, as expected, were more reliant on own-source revenues, namely commercial rates and charges/fees for goods and services. Consider, for example, the revenue incomes of Galway City Council versus Leitrim County Council. In Galway City Council, own-source revenues (commercial rates and charges for goods and services) accounted for over two-thirds, or 68.9 (35.5 and 33.4, respectively) per cent, of income. In Leitrim County Council it was the central government transfers (specific purpose and general purpose grants) that accounted for a majority, or 77.3 (42.9 and 34.4, respectively) per cent, of revenue income in 2007. Taking commercial rates as a locally determined revenue source, this accounted for *only* 6.4 per cent of revenue income in Sligo County Council whereas it accounted for 44.3 per cent of revenue income in Fingal County Council. In contrast, taking the general purpose grant as a central government transfer, this accounted for 34.2 per cent of revenue income in Longford County Council but only 12.6 per cent in Dublin City Council in 2007. Table 5 reports the composition of revenues for city, county and all (city, county, borough and town) councils for 2007.

**Table 5: Composition of revenues by type, 2007**

| | *City councils (%)* | *County councils (%)* | *Total (%)* |
|---|---|---|---|
| Charges for goods & services | 30.8 | 26.1 | 27.7 |
| Commercial rates | 35.8 | 22.0 | 26.8 |
| Specific purpose grants | 19.9 | 29.5 | 25.5 |
| Local government fund | 13.5 | 22.4 | 20.0 |

*Source:* Commission on Taxation Group (2009).

We now turn to the years of the economic downturn and the subsequent fiscal crisis. In particular, we address the question of whether there was a budgetary crisis at the subnational – city and county council – level and, if so, how it differed, if at all, from the national fiscal crisis.

## Economic bust and local government budgets

In 2008 the then Minister for Finance, Brian Lenihan, remarked that he had the 'misfortune' to take up office just as the property boom was coming to a 'shuddering end'. The impact on the national government budget was dramatic. The fiscal or general government balance, which had been in surplus at 2.9 per cent in 2006, was in deficit at 7.3 per cent in 2008, 13.9 per cent in 2009 and 30.9 per cent in 2010.[5] Exchequer tax revenue, which had totalled €47.2 billion in 2007, fell to €40.8 billion in 2008, with further falls in 2009 (to €33 billion) and 2010 (to €31.8 billion) (Department of Finance, 2012). In respect of the different sources of tax revenue, all taxes relating to the property market (e.g. stamp duty, VAT, capital gains) plummeted. For example, stamp duty (on all transactions, property and otherwise), which had totalled €3.2 billion in 2007, fell to less than €1 billion by 2010.

The economic crisis – caused by a number of factors, including the 2008/9 financial crisis and the international recession, a near banking collapse and a property bubble – had resulted in a fiscal crisis, comparable to the budgetary problems of the 1980s. As fiscal deficits increased, the government debt as a percentage of GDP soared, from a relatively low 24.6 per cent in 2006 to 64.9 per cent in 2009 and to 92.2 per cent by 2010. With the state guarantee of the bank liabilities adding to Ireland's debt burden, the result was a sovereign debt crisis (one of many in the eurozone) and Ireland's bailout by the International Monetary Fund/EU in late 2010.

While all of this was happening at the national, and indeed supranational (particularly eurozone and EU), level, our focus in this paper is on developments at the local level. More particularly, what was the impact on local government budgets? How did own-source revenues fare? What about user charges and fees? What happened levels of central government transfers – both specific purpose and

[5] The 2009 and 2010 deficits include the cost of the recapitalisation of the financial institutions as part of the bank bailout. The underlying deficits were 11.5 per cent and 10.8 per cent, respectively. See footnote 1.

general purpose grants? Aside from these changes in revenues, what expenditure patterns emerged? In general, how have local governments coped with the fiscal strain brought on by the financial crisis and the subsequent economic downturn?

We begin with a comparison between central and local government budgets for the period 2008–10, where we have actual out-turns available. Table 6 shows (current) revenues and expenditures, with the annual percentage change for each of the three years and the percentage change for the three-year period reported.

**Table 6: Central versus local government budgets, 2008–10**

| | *2008* | *2009* | *2010* | *2008–10* |
|---|---|---|---|---|
| | | *(% change)* | | |
| **Central government** | | | | |
| Revenue | –13.1 | –18.6 | 1.7 | –28.1 |
| of which tax revenue | –13.7 | –19.0 | –3.9 | –32.8 |
| Expenditure | 9.3 | 1.2 | 3.9 | 15.0 |
| **Local government** | | | | |
| Revenue | 3.8 | –3.9 | –0.8 | –1.0 |
| of which tax revenue (commercial rates) | 7.0 | 3.8 | 1.5 | 12.7 |
| Expenditure | 5.8 | –5.2 | –1.0 | –0.6 |

*Source:* Department of Finance; Department of the Environment, Community and Local Government; authors' calculations.
*Note:* The annual inflation rates for the years 2008–10 were 4.1, –4.5 and –1.0 per cent, respectively, amounting to an inflation rate of –1.6 per cent for the three-year period of 2008–10.

The contrast is striking. In 2008, and unlike the effect at the national level, local government revenue, in nominal terms, actually increased (as indeed did local revenues in other EU member states), and for all sources of income. It was only in 2009 and thereafter that the crisis began to hit local government funding. As with other downturns, here and elsewhere, the negative impact of this recession on the local government budget began to impact only *after* it had affected the national budget. For the three years of 2008–10, central government revenue fell by 28 per cent, whereas local government revenue fell by only one per cent. The difference is even more striking when tax revenues are considered. Central government tax revenues were one-third lower in 2010 than in 2007. In comparison, revenues from commercial rates (the only local tax) were one-eighth *higher* in 2010 than in 2007. With respect to expenditures, whereas local government spending remained constant over the three years, central government expenditure increased by 15 per cent, with much of this increase due to higher social security and welfare spending (almost exclusively, and unlike in many other countries, a responsibility of central government in Ireland) arising from the downturn. In response to the fiscal crisis, the reversal in income trends and a renewed focus on efficiency gains, local authorities implemented a number of cost-saving measures, most especially in relation to staffing and payroll costs.[6] For example, in terms of public sector numbers, whereas local authorities witnessed a 12 per cent reduction in staff numbers in the three years of 2008–10, with further reductions of four per cent per annum in both 2011 and 2012, the reductions in the total public sector were much smaller (less than 7 per cent as against almost 20 per cent in local government, for the five-year period of 2008–12) (data taken from http://databank.per.gov.ie).

Tables 7 and 8 report the recurrent income and expenditure of local governments for 2008–12, coinciding with the downturn in the economy and the public finances crisis.

As already evident from Table 6, the 2008–10 changes in local government revenues and expenditures were not dramatic. However, the pattern of revenue and expenditure changes since 2010 is different. As in previous recessions where there was a similar time lag in terms of the effect on local budgets, local governments internationally continue to be adversely affected after the general recovery has begun, as central government tries to restore order to the national public finances by, inter alia, passing down expenditure responsibilities to subnational governments without the commensurate resources and/or, as in the Irish case, reducing block grants. As for the length of time it takes to recover, it may be the case that the post-crisis recovery for the local authorities may also take longer. Revenue income continued to fall in 2011 and 2012, unlike central government revenues, which had begun to stabilise by 2010. As a result, expenditure adjustments continued. By 2012, local government (budgeted) revenues and expenditures were 8 per cent lower than their level in 2007. With

[6] Further details can be found in the 2010 report of the Local Government Efficiency Review (LGER) Group and the subsequent report of the LGER Implementation Group, published in March 2012. We wish to thank one of the reviewers for highlighting the importance of, and subsequent actions taken in respect of, the efficiency savings and the shared services agenda of local government.

**Table 7: Local government revenue, 2008–12**

| | *2008* | *2009* | *2010* | *2011* | *2012* | *2008–12* |
|---|---|---|---|---|---|---|
| | | | *(% change)* | | | |
| Total, of which | 6.3 | 0.2 | –7.7 | –2.5 | –4.3 | –8.3 |
| Charges/fees | –4.9 | 1.9 | –7.3 | –6.0 | –5.3 | –20.0 |
| Commercial rates | 8.0 | 4.5 | –3.2 | 0.7 | 6.8 | 17.3 |
| Specific purpose grants | 20.5 | –1.3 | –12.0 | 2.2 | –15.1 | –9.3 |
| General purpose grant | 6.0 | –6.3 | –9.0 | –8.2 | –6.8 | –22.6 |

*Source:* Department of the Environment, Community and Local Government; authors' calculations.
*Note:* These are budgeted figures as, at the time of writing, the (audited) consolidated actual out-turns were only available up to 2010. The annual inflation rates for the years 2008–12 were 4.1, –4.5, –1.0, 2.6 and 1.7 per cent, respectively, amounting to an inflation rate of 2.7 per cent for the five-year period of 2008–12.

respect to revenues, the combined budgeted income in 2012 from charges and fees for goods and services and the general purpose grant was one-fifth lower than its level in 2007. In relation to expenditures, local government combined budgeted spending on environmental services and road transportation and safety was one-quarter lower than its level five years earlier. On the other hand, (budgeted) revenue from commercial rates and (budgeted) spending on housing, water services and development management increased over the five-year period of 2008–12.

## Further analysis of city and county councils' finances

Given the trends at an overall local government level before and after the onset of the economic crisis it may also prove useful to analyse the impact of the downturn on local government at a specific council level. To this end, Figure 1 illustrates the percentage changes in total revenues, commercial rate income and general purpose grant amounts across each county/city council in Ireland over 2007–12.

While the general trend supports the overall picture at local government level of increased commercial rate income combined with lower revenues and grants amounts, the figure illustrates a significant amount of variation on these changes across the different councils. For

**Table 8: Local government expenditure, 2008–12**

| | 2008 | 2009 | 2010 (% change) | 2011 | 2012 | 2008–12 |
|---|---|---|---|---|---|---|
| Total, of which | 6.5 | 0.2 | –7.6 | –2.3 | –4.2 | –7.7 |
| Housing & building | 11.2 | 4.5 | –6.5 | –0.8 | –0.3 | 7.5 |
| Road transportation & safety | –5.6 | –3.4 | –19.6 | –4.5 | –0.9 | –30.6 |
| Water services | 17.2 | –1.3 | –4.1 | –1.7 | 0.3 | 9.4 |
| Development management | 28.9 | 4.6 | –12.9 | –4.7 | –3.2 | 8.3 |
| Environmental services | 7.8 | –6.6 | –8.7 | –6.8 | –10.7 | –23.5 |
| Recreation & amenities | 5.7 | 4.0 | –10.8 | –3.3 | –3.1 | –8.1 |
| Agriculture, education, health & welfare | 11.5 | 6.4 | 16.0 | 5.2 | –42.9 | –17.3 |
| Miscellaneous services | –3.3 | 11.5 | 13.4 | 3.9 | 29.4 | 64.2 |

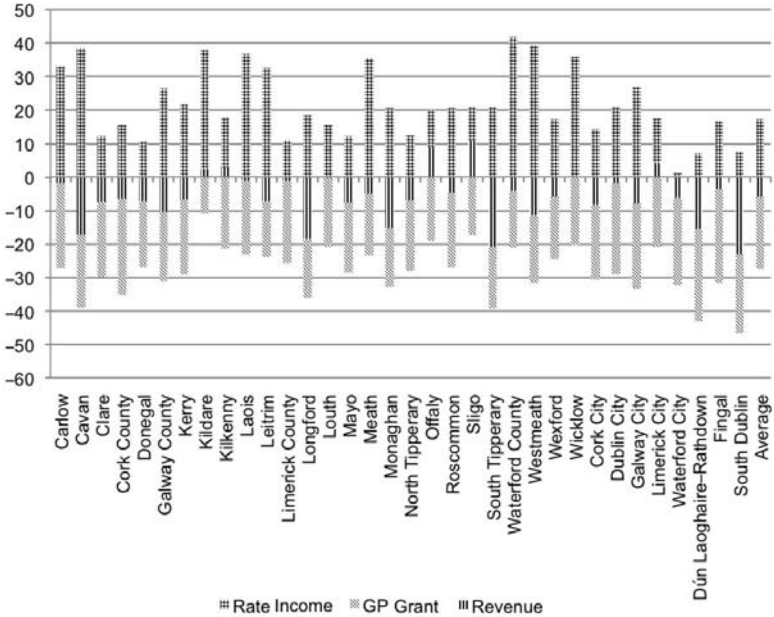
*Source:* Department of the Environment, Community and Local Government; authors' calculations.

*Note:* These are budgeted figures as, at the time of writing, the (audited) consolidated actual out-turns were only available up to 2010. The annual inflation rates for the years 2008–12 were 4.1, –4.5, –1.0, 2.6 and 1.7 per cent, respectively, amounting to an inflation rate of 2.7 per cent for the five-year period of 2008–12. See Table 2 note for an explanation of discrepancy between (changes in) total income and expenditure amounts in Tables 7 and 8.

instance, with regard to revenue changes across 2007–12, Sligo County, Offaly County and Limerick City Councils have actually experienced increases in revenue, while county councils such as Cavan, South Tipperary and Longford have seen significant reductions in revenue. There was also huge variation in relation to the changes in commercial rate income over this period, with Westmeath and Waterford County Councils witnessing increases of roughly 40 per cent. This is in contrast to other councils such as Dún Laoghaire–Rathdown and South Dublin County Councils and Waterford City Council, whose increases in commercial rate income were approximately 7, 7.5 and 1 per cent, respectively.

These changes raise a number of important questions, namely what is the main impact of these changes and why do we see such cross-

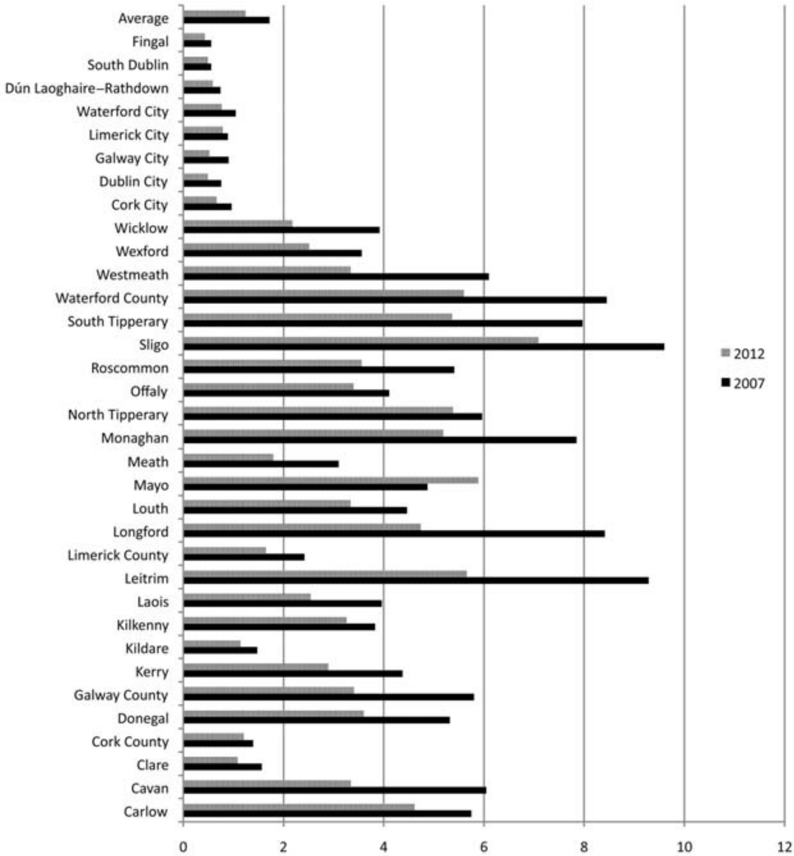
**Figure 1: Percentage changes in commercial rate income, general purpose grant amounts and total revenue for each city/county council in Ireland, 2007–12**




council variation in these numbers? With regard to the former issue, we first highlight the fall in the dependency ratio of each council across the period as a result of falling central government transfers and increasing commercial rates. The dependency ratio is expressed as the ratio of central government grants (general purpose and specific purpose) to local tax revenues (OECD, 2008). Figure 2 illustrates the significant fall in this ratio for many councils in Ireland with the average level of dependency ratio falling from 1.72 in 2007 to 1.25 in 2012.

While this is no great surprise given the reduction in general government transfers to subnational level, it is interesting to note the variations in this dependency ratio across councils. As the OECD (2008) notes, the more rural local areas of Ireland are heavily reliant on central government transfers; however, these are also the councils that have seen the greatest falls in dependency across our reference period. For instance, rural counties such as Leitrim and Longford have

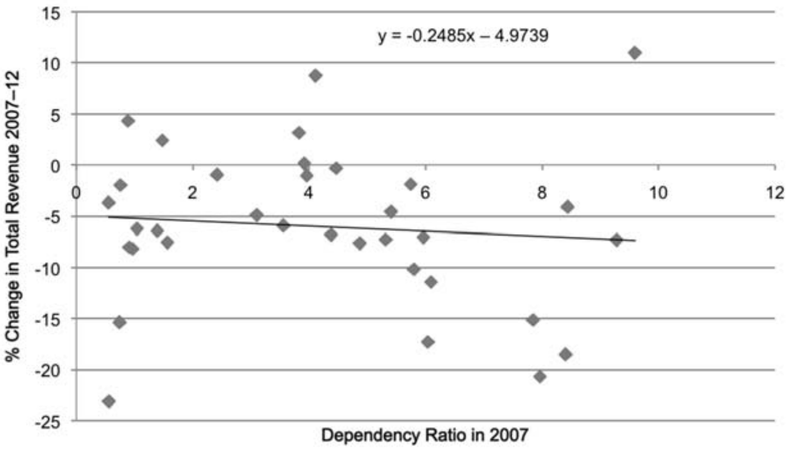
**Figure 2: Dependency ratios for city and county councils in Ireland, 2007 and 2012**




seen significant falls in their level of dependency relative to the more urban areas of Dublin, Limerick and Cork city. These rural counties would have had quite high dependency ratios in 2007 and the variations in local government finances to 2012 have resulted in this dependency being partly eroded. However, it is also notable that from 2007 to 2012 Waterford City Council witnessed a fall in its dependency ratio from above 1 to 0.77. This can be considered significant as it has now reached a situation in which the city council's local commercial tax base is of more importance financially than central government funding. In this context, the decision by central government to increase the percentage of the new LPT that can be retained by the respective local authority area from the initial 65 per cent to 80 per cent collected in localities has very important and contrasting implications for urban areas where residential property prices are higher, as against rural areas where revenue from the LPT will be limited due to a smaller base and lower property prices.

Using the data on revenue income and dependency ratios from Figures 1 and 2, respectively, Figure 3 illustrates the negative relationship between the percentage change in total revenue from 2007 to 2012 and the dependency ratio of each council in 2007. This shows that those councils that were most reliant on central government funding saw the biggest drop in revenue during 2007–2012, as the central government transfers shrank and increases in commercial rates were unable to keep pace with this decrease.

**Figure 3: Relationship between dependency ratio in 2007 and revenue changes during 2007–12**




While the analysis above provides some understanding of the possible implications of the changes in local government finance at a city/county level, another area worthy of discussion is the reasons behind the wide variation in the general purpose grant decreases at a city/county level, as seen in Figure 1. In theory, the general purpose grant is based on objective allocation criteria, namely the needs and resources model. However, as the OECD (2008) notes, in practice this may not be the case, with amounts open to negotiation and lobbying as allocations are mainly based on baseline projections following trends in the past. Figure 1 shows large differences in the changes to the general purpose grant amounts at a city/county level, varying from a 28.6 per cent decrease in Cork County Council to just under an 11 per cent decrease in Kildare County Council. From a strictly rational viewpoint these decreases would be determined by the relative needs and resources of each city/county council. Therefore, it may be interesting to investigate if this has held true in the decreases seen across our reference period. Table 9 presents the results of a simple OLS (ordinary least squares) regression with the percentage change in the general purpose grant from 2007 to 2012 for each local authority as the dependent variable. As we did not have the exact specification of the needs and resources model used by central government in administering this grant, we utilised proxy variables instead for our independent variables. We included population changes in each respective city/county council across this period as a proxy for the needs of the area, while we also included the change in the Net Effective Valuation (NEV) of the city/county council as a proxy for changes in resources.[7]

**Table 9: OLS regression of changes in general purpose grant against changes in population and net effective valuation, 2007–12**

| | |
|---|---|
| Population | 0.39* |
| NEV | 0.18 |
| Constant | –34.9*** |
| Observations | 31 |
| $R^2$ | 0.29 |

*Note:* * p < 0.1; ** p < 0.05; *** p < 0.01. The three County Dublin councils were omitted from the analysis because of the recent revaluations of commercial and industrial property carried out in these three local authorities.

While the results are simplistic in nature, they suggest that the changes to the general purpose grant payments can be explained somewhat by changes in the population of each city/county council in the 2007–2012 period, but not from changes in the NEV. While a more robust analysis of this relationship may be explored in the future, the results provide a useful insight into the possible drivers of the varying

[7] Due to data constraints the population changes included are from 2006 to 2011. As for resources, the NEV is the cumulative total of all valuations of rateable premises throughout the city and county councils. The three County Dublin councils of Dún Laoghaire–Rathdown, Fingal and South Dublin were excluded from this particular analysis as they have undergone significant revaluations of their respective rateable premises across some of this period and may have induced outlier bias within the results.

decreases in this area of central government funding to local authorities.

## Concluding remarks

Before we make some concluding remarks, a number of caveats in relation to local government in Ireland and the effect of the economic downturn are worth noting here. One, as Irish local authorities do not engage in capital market borrowing, the impact of the credit crunch on local authorities in Ireland was much less than elsewhere. At the outset of recession, city and county councils were not heavily indebted. Unlike the actions of their national counterpart, borrowing by local authorities during the recession did not excessively increase. At the end of 2010, local government debt as a percentage of GDP was just over 3.5 per cent in Ireland as compared with rates closer to 6 per cent for both the eurozone and EU average (Council of Europe, 2011).[8]

Two, as local government in Ireland is not responsible for social services provision (with the exception of social housing), the increase in the demand for welfare spending associated with the downturn has not affected local authorities in Ireland as much as in subnational governments elsewhere. The biggest impact of the crisis on local government spending was likely to come from the increase in the demand for social housing. According to the department's triennial housing needs assessment report, the net housing needs of the local authorities increased by 75 per cent in the period 2008–11 – from 56,249 households in 2008 to 98,318 households in 2011 (Housing Agency, 2011). Although difficult to establish accurate figures, the number of homeless also increased during this period.[9]

Three, on the revenue side, as commercial rates are the main own-source revenue for local authorities, the biggest impact of the crisis on

[8] In the three-year period of 2008–10 there was a 20 per cent increase in the level of local government debt in Ireland. This compares with a smaller rise for the eurozone (9 per cent) and the EU (14 per cent) as a whole, but more favourably when compared with many individual EU or eurozone countries (Council of Europe, 2011). According to the IMF Fiscal Affairs Department, 'Local governments do not appear to be a significant source of fiscal risk in Ireland owing to the small size and lack of financial autonomy' (IMF, 2013).

[9] See *Housing Needs Assessment 2011* (Housing Agency, 2011) for methodological notes on measuring housing needs and changes in measurement over time. As for measuring (once properly defined) homelessness, it is generally regarded, here and elsewhere, to be a difficult task with the reported numbers likely to be an underestimate of the true level.

revenue-generating sources was likely to come from the increase in business closures. The recession has greatly reduced the size of the business sector, increasing the fiscal stress on the remaining local taxpayers. As for the trend in commercial rates nationwide, annual increases (in the range of 3–5 per cent per annum in the mid 2000s) in the ARV continued up to and including 2009 (just over 1 per cent), with annual reductions of less than 1 per cent per annum in the years 2010–12.

On a more positive note for local government (but not so for central government), local authorities in Ireland may not have been exposed as much to the downturn as other subnational governments elsewhere. Unlike in countries where property tax is the most common local tax, with local governments as a result witnessing declines (but less than one might have expected as in many EU countries property tax is not based on current market values) in property tax receipts due to the property crash and the related decline in construction and real estate activity, subnational governments in Ireland had no residential property tax and thus did not experience a fall in property tax receipts during the downturn. On the downside for local authorities, local governments in Ireland, as elsewhere, have fewer instruments to protect themselves against downturns and fiscal crises.

Four, capital expenditure by local governments in Ireland was very significant during the boom years and remained so, although at a lower level, in the early years of the downturn. In 2011 capital expenditure by city and county councils had fallen to less than €2.2 billion (from over €6 billion in 2007/8). This is still a significant amount of investment spending when compared to the EU average or to total public capital expenditure in Ireland.

On a positive note, the crisis provided the authorities with the opportunity to introduce a local tax in the form of the LPT, where revenues, it is anticipated, will accrue to the local authorities (with, it is proposed, 80 per cent of the property tax to be retained in the local authority area where it is collected) and, ideally in terms of greater fiscal autonomy, the local government will acquire rate-setting powers. This will increase local autonomy and make for a system of local government that is both more efficient, in terms of resource allocation, and more responsible, in terms of accountability to its local residents and taxpayers. To date (writing in early 2013), in Ireland and generally elsewhere, the impact on the national budget appears more severe than the impact on local government budgets. This is not surprising given that the national budget is generally dependent on more vulnerable revenues, responsible for the vast bulk of social assistance, the initiator of, if any, fiscal stimulus packages and also, as happened in many countries, the funder of bank bailouts.

Although cross-country comparisons are often interesting and worthwhile, meaningful comparisons of local governments across the EU are difficult given the differences in structure, functions and funding of local governments throughout the EU. It is likely that the impact of the downturn differed, depending on local public finance systems and specific circumstances. For example, it depends on the extent of expenditure assignment, and particularly social assistance responsibilities of local government; the mix of revenue sources (including, on the tax side, property tax, business tax or surcharges on personal income tax, corporation tax and VAT); and the ability of local governments to borrow or have access to external funds, e.g. structural and cohesion funds, as with the new EU accession countries. One difference is the flow of intergovernmental transfers. In some EU countries grants from the centre to the local governments actually increased during the downturn or at least in the initial years as some central governments compensated local governments for falling revenues and rising expenditures. For example, in England, grant income to the local authorities rose, in nominal terms, in both 2009 and 2010 – by 2.9 and 7.2 per cent, respectively – as locally funded income (council tax, council rents, fees and charges) fell in 2009 by 1.6 per cent (Department for Communities and Local Government, 2012). Likewise, in some EU countries there was a fiscal stimulus package implemented that benefited local government. This was not the case in Ireland as austerity and fiscal consolidation have been the dominant features of central government budgets since the downturn began.[10]

In summary, the motivation for this paper was to assess, as much as possible given the available data, the impact of the economic crisis on local government budgets and funding. Similar to the impact on the

[10] Indeed, as elsewhere, the requirement for local authorities to adopt a balanced budget has restricted local governments from adopting counter-cyclical policy. In doing so, adjustments to spending and public services delivery on the one hand and to changes in commercial rates and charges for goods and services on the other hand have reinforced the business cycle. Furthermore, the scope for local government borrowing is subject to the *EU/IMF Programme of Financial Support for Ireland*, which stipulates that 'effective measures are in place to cap the contribution of the local government sector to general government borrowing at an acceptable level' (Department of Finance, 2010). Thanks to one of the anonymous reviewers for this and other points on local authority staff numbers, and limits and external scrutiny of local government borrowing.

national budgets, the effect has been significant. Revenues have fallen, as have local authority expenditures. However, there have been differences between the impact on the national budget and these effects on local budgets. Whereas the national budget witnessed a large and sudden decline in revenue in 2008, this was not the case for local authority budgets. Indeed, some sources of revenue to local government, namely commercial rates and the general purpose grant, witnessed sizeable increases in 2008. Although revenues declined in subsequent years, the fall was much less when compared to the decline in central government revenues. In addition, as with downturns elsewhere, the negative impact on local government finances continues and it is likely to be longer in duration than that witnessed by the national government finances.

Finally, local government finances are likely to be affected by planned changes to the local government system in Ireland. The introduction of the LPT in 2013, and the plan to allow local authorities to vary the rate from January 2015 onward (by +/-15 per cent of the national central rate), will see changes to how local governments finance their activities and also affect the (amount and design of) grant income from central government. The minister also plans to reform local government, as announced in October 2012 with the publication of *Putting People First* (Department of the Environment, Community and Local Government, 2012). Although much of these planned changes relate to the structure of the local government system in Ireland (abolition of town councils, establishment of municipal districts, etc.), there are also planned changes to certain expenditure responsibilities of local government. We eagerly wait to see what impact these reforms might have on the funding and finances of local governments in Ireland.

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