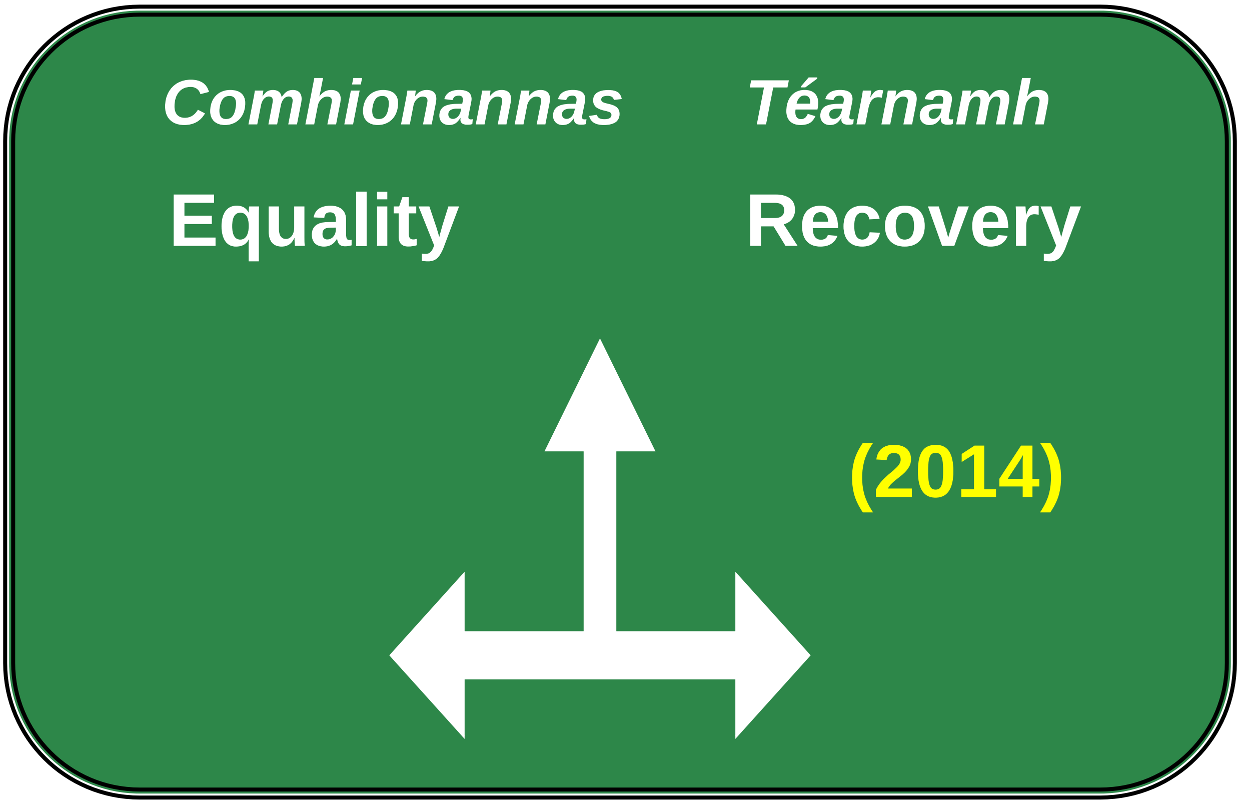

BUDGET 2014:

Choosing an Equitable Route to Recovery

TASC

Think-tank for Action on Social Change

Independent research, challenging inequality and promoting a flourishing society

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Preface

The overwhelming balance of international evidence shows that policy on addressing the public finances needs to change and that an alternative approach to closing the deficit and recovering the economy is urgently required. The window of opportunity from pushing out the promissory note repayments has opened up debate on the level of adjustment for 2014 to a much greater extent than in previous years' budgets. TASC urges the government to take advantage of that opportunity by constructing a budget that meets our deficit reduction targets but that also puts the stimulation of growth and jobs at the top of its economic and social agenda for 2014, and begins to rectify the economic inequalities in our society.

There is no doubt that the Irish public interest lies in lowering the deficit and controlling the extent of the national debt. Already, a huge inter-generational inequality has been created, with the legacy banking costs and the debt repayments passed on to the younger generations, who are already struggling with excessive personal and business debt from the boom period. However, further cuts to public services are likely to deepen inequality in society and put Ireland's economy onto a lower developmental trajectory for years to come.

TASC's analysis is that no further cuts should be applied to public services, beyond the savings agreed in the Haddington Road Agreement, which should realise €350 million in savings in 2014.

Moreover, the adjustment in the public finances to be made in 2014 should be lower than €3.1 billion, off-set by increased investment and all adjustments should be made on the revenue side. TASC has produced a fully-costed budget that would lower the deficit using a balance of measures that are progressive and targeted on societal wellbeing.

The Deficit Reduction Target

There are significant risks and negative consequences associated with making an excessive adjustment, such as the figure of €3.1 billion (net) that has been discussed. The official target to reduce the deficit to 5.1 per cent of GDP is a politically agreed figure, not rooted in any empirical studies of best practice.

The consequences of making an excessive budget adjustment include:

- Embedding a high level of structural long-term unemployment in the economy – in other words, destroying jobs and businesses that will not return, and causing a situation where people's skills degrade and they find it increasingly difficult to return to work;
- Further reducing social protection and welfare at a time when many people on lower incomes are already under severe strain;
- Moving the Irish economy to a lower long-term growth equilibrium – i.e. damaging Ireland's future potential to grow the economy, which can be seen with the closure of potentially successful businesses, the running down of productive infrastructure and human capital, and the emigration of talent;
- Contracting the economy, thereby lowering economic growth in the short-term, and thus making it even harder to repay the national debt.

Recent evidence suggests that growth projections linked to budget adjustments have been systematically over-optimistic and larger adjustments will lead to worse growth and employment outcomes than anticipated. The 'multiplier' effect of previous budget adjustments is likely to have been much worse than anticipated and continuing in the same direction risks severe damage to the economy and societal wellbeing.

The re-engineering of the promissory note repayments has opened up debate on the level of adjustment for 2014 to a much greater extent than in previous years' budgets. The 2014 saving of around €900 million could be interpreted as reducing the required adjustment from €3.1 to €2.2 billion. As part of the effort to restore sustainability in the public finances TASC is proposing that the discretionary adjustment in 2014 should not exceed €2.7 billion. Even then, the adjustment (beyond savings under the Haddington Road Agreement) must be made entirely on the revenue side to avoid deepening the crisis in jobs and living standards. However, a narrow focus on deficit reduction would be deeply misguided. The consolidation measures proposed for Budget 2014 will have a substantially contractionary effect on growth and employment. Therefore TASC proposes that the discretionary fiscal adjustment should be accompanied by an investment based stimulus. The recently announced Ireland Strategic Investment Fund (ISIF) which is to be funded using €6.4 billion from the National Pension Reserve Fund is to be welcomed as an important counter-balancing measure to boost growth. It is proposed that at least €1.5 billion from the ISIF be fast-tracked in 2014 to offset the contractionary effects of the budget.

The Haddington Road agreement is set to deliver €350 million of savings in 2014. In addition, carryover measures (such as a full year of revenue from the property tax) will raise an additional €600 million in 2014. That leaves a requirement to identify net €1.75 billion in new consolidation measures.

A Process of Elimination to Identify Economically Efficient and Equitable Budget Adjustments

In order to identify the most appropriate set of measures for fiscal consolidation, TASC identified the possible options and engaged in a process of elimination to identify measures which, when considered as a package, would carefully balance economic efficiency with social equity.

In brief, the first option is to 'go for growth', so that a growing GDP will shrink Ireland's debt in relative terms while fostering a positive feedback loop of higher employment, higher tax revenues and lower demand for social transfers. Investment by the new Ireland Strategic Investment Fund (ISIF) will go some way to fostering growth, but even the most optimistic estimates for growth in 2014 are far beneath what is required to address the deficit. Hence, additional measures are still required.

A politically expedient – but damaging – option is to further reduce capital expenditure. Ireland already has the lowest level of investment in the EU at 10 per cent of GDP (versus an average for the EU27 of 17.9 per cent). Further cuts in capital expenditure would undermine Ireland's medium term growth potential and run counter to the goal of long-term debt sustainability, so cuts in capital expenditure should be avoided.

The Haddington Road Agreement has drawn a line under the possibility of further reductions in public pay and pensions and is set to deliver €350 million in expenditure savings in 2014.

TASC argues strongly that further reductions in public spending – especially social transfers/welfare – should absolutely not occur in Budget 2014. CSO figures from 2011 show that Ireland suffers from high levels of enforced deprivation (24.5 per cent) and risk of poverty (16 per cent), not least child poverty. The level of enforced deprivation has more than doubled since 2007, when it was 11.8 per cent. Lower welfare spending (which disproportionately goes to low income households with very high propensities to consume) also means lower aggregate demand across local economies in Ireland.

Any savings within Departmental budget lines should be used to boost social transfers and other much needed programmes (e.g. mental health/addiction, homelessness, domestic violence, job creation, SME loan guarantees, etc.) in other areas of the budget, not to lower the deficit.

TASC's analysis is that further reductions in public expenditure at this stage will result in long-term damage to education, health and other areas of public services. More cuts risk being false economies, resulting in additional costs to the economy and exchequer in the medium term. Vital programmes such as homeless services and mental health services need increases to cope with much higher demand, not cuts.

Another option is to raise service charges for public services, but on the whole these tend to be regressive, with lower income households bearing the brunt. TASC has developed a model for equitable water charging based on assigning lower income households 'water credits', but water charging should not proceed as part of Budget 2014.

As an aside, too little has been done to address the ways that Government can reduce the cost of living for people, as compensation for the loss of social transfers and increased taxation. For example, Government could influence rent levels, utility prices, transport costs and professional fees. These measures would also help small businesses.

It is unlikely that higher inflation targets or enhanced fiscal transfers at EU level will manifest to assist Ireland in dealing with its debt burden (e.g. due to the ECB's strongly anti-inflationary monetary policy).

Hence, as a result of going through a process of elimination, combined with an analysis of Ireland in comparison to our European partners, TASC argues that the remaining €1.75 billion in new adjustments should be entirely achieved through various changes to increase Ireland's tax revenue, as discussed below.

The Focus on Taxation

The annual Eurostat publication, *Taxation Trends in the European Union*[1], provides a strong evidence base to examine the peculiarities of the Irish tax and social insurance system. This evidence shows that Ireland's overall tax take is low compared to EU averages. (In 2011, Ireland's total revenue, including social insurance, was 28.9 per cent of GDP compared to the EU27 weighted average of 38.8 per cent – less than three-quarters of the average level of European taxation).

This anomaly is based on three notable idiosyncrasies in the Irish tax system. Firstly, taxation is highly centralised in Ireland. Secondly, Ireland's level of social insurance is extremely low. In 2011, the EU27 weighted average was for social contributions of 12.7 per cent of GDP, making up 37.3 per cent of all tax revenue. In Ireland, social contributions were only 5 per cent of GDP (the third lowest in the EU27), and made up 16.4 per cent of tax revenue (less than half the EU27 average). Thus Ireland's social contributions trail the EU27 by a substantial 7.7 per cent of GDP. Finally, the level of tax expenditure/tax breaks available in Ireland is very high and greatly undermines horizontal equity in the income tax system.

For example, consider this: Ireland's level of employer contributions to social security is so much lower than the EU27 average level, that the entire planned budget adjustment of €5.1 billion for Budget 2014 and Budget 2015 could be achieved from this one source without raising these contributions above the EU27 average. However, TASC's analysis is that now is not the right time to greatly increase social insurance costs (as this affects labour costs and major increases would impact on employment).

Based on the above considerations, combined with a desire to maximise job growth and preserve social equity, TASC's focus for Budget 2014 has been on the reduction of inequitable tax breaks and the introduction of targeted tax changes that would have a demonstrable social benefit to outweigh the sometimes regressive nature of the tax increases identified. All the figures cited are based on published data from Government sources or are drawn from academic sources.

TASC's Proposed Measures for Budget 2014

TASC's proposals for Budget 2014 are outlined in more detail in the table on pages 16-17. In summary, these measures target wealth, wealth transfer and passive income (i.e. income derived from wealth/assets, such as rent) as well as reform of pension-related tax reliefs. TASC proposes one measure of labour taxation, which is to introduce a higher level of employer PRSI contributions on the portion of salaries above €100,000. This will affect relatively few employments (45,090), addresses to a small extent the major shortfall of employer social contributions in Ireland and does not affect the marginal tax rate on employee salaries.

TASC also proposes excise increases on socially 'bad' goods and services (e.g. tobacco, alcohol and gambling). While recognising that the distributional impact of these measures may be regressive, in terms of people on lower incomes paying proportionally more, this is counter-balanced by the social benefits and should be seen in the overall context of the package of highly progressive tax measures which are being proposed. Additionally, TASC proposes environmental taxation and increasing the Revenue Commission's human resources.

Combined with the expenditure savings from the Haddington Road Agreement and the carry forward effects of previous Budgets, these measures provide for an economically efficient and socially equitable budget adjustment of €2.7 billion in 2014 which, when considered alongside investment of €1.5 billion from the ISIF, would provide for a prudent but equitable stabilisation of the public finances.

The international evidence shows that excessive consolidation, or consolidation focused on the wrong areas, can have disastrous economic and social consequences. TASC's budget analysis demonstrates that it is in fact possible to lower the deficit in a way that is economically efficient, good for jobs and consistent with equality and social justice.

Nat O'Connor
Director, TASC

Section One

1.1 Social, Economic and Budgetary Context

1. Irish society is under severe strain. Risk of poverty has increased from 23.1 per cent in 2007 to 29.4 per cent in 2011[2], compared to EU27 averages of 24.4 and 24.2 per cent respectively. In other words, while poverty decreased on average in Europe, it has increased by over a fifth in Ireland. The Irish national measurement of poverty risk (not comparable with EU statistics) is 16 per cent, and the rate of enforced deprivation is 24.5 per cent, up 12.7 percentage points from a rate of 11.8 in 2007. That means more than twice as many people – and nearly a quarter of the population – are now experiencing circumstances such as being unable to adequately heat their homes, provide substantial meals and/or purchase adequate clothes or footwear.

2. Income is far from the only variable involved in social wellbeing. Insecurity about current employment or anxiety about unemployment and future job prospects are insidiously damaging families and communities. Inability to meet rising housing costs and worry about loss of health care services and the cost of education are all consequences of social policy decisions and reduced public expenditure on services. Further cuts to programme budgets will have grossly disproportionate effects on the welfare and wellbeing of communities and families. This in turn is highly likely to lead to long-term costs on the public purse, from worsening health, lower education (and lower employment potential) and higher crime. There is a false economy in pursuing further cuts, which needs to be scrutinized in comparison with the continuing inequity and relative weakness within Ireland's taxation and social insurance systems.

3. The context for Budget 2014 is the unsustainable deficit in the public finances and a highly elevated debt to GDP ratio. The underlying general government deficit will be in the region of 7.4 per cent of GDP in 2013 (€12.5 billion) while the debt ratio is expected to peak at around 123.3 per cent of GDP (€207 billion). Ireland is currently operating under an Excessive Deficit Procedure (EDP) agreed with the European Commission and as part of this procedure has a minimum target for the general government deficit of 5.1 per cent of GDP in 2014. The EDP ceiling for 2015 is 2.9 per cent. Some of this deficit is 'cyclical' in that it is a function of the economic cycle. However, much of the deficit is likely to be structural indicating there would still be a substantial deficit even if the economy was operating at its long-term potential level[3]. We do not know the actual structural balance as it is a theoretical construct that cannot be directly observed. Existing estimates of it are based upon highly contentious assumptions. See Table 1 for the Department of Finance's (DOF) current estimates of the structural balance. The DOF's Stability Programme Update (SPU) indicates that a discretionary fiscal adjustment (net) of €3.1 billion will take place in Budget 2014 as part of the DOF's chosen strategy to reduce the deficit below the EDP ceiling.

4. Economic growth remained sluggish in 2012 (real GDP growth was just 0.2 per cent) due to a combination of pro-cyclical fiscal consolidation; extremely high levels of household and corporate indebtedness; on-going private sector deleveraging; liquidity constraints and weakness in Ireland's major trading partners. The trend of weak growth in real GDP has continued into 2013. The average forecast for a range of institutions (see Table 2) suggests that growth will start to pick-up from 2014 onwards. However, the recent optimistic trend in growth forecasts may suggest a systematic error in forecasting models, for example an underestimating of the impact of fiscal consolidation during recessions, or an underestimation of the negative impact of liquidity constraints.

5. Unemployment remains very high at 14 per cent and is set to remain in double digits until at least the second half of the decade (see Table 3). Of particular concern is the high rate of long-term unemployment which stood at 8.4 per cent in the first quarter of 2013. There is a risk that this high rate of long-term unemployment will evolve into a high rate of structural unemployment. Such an occurrence would have severely negative consequences for the economy's long-run output potential.

Table 1: Public Finance Projections

% GDP	**2012**	**2013**	**2014**	**2015**	**2016**
Underlying General Government Balance	-7.6	-7.4	-4.3	-2.2	-1.7
Underlying General Government Primary Balance	-3.9	-2.5	0.5	2.7	3.2
Structural Budget Balance	-7.3	-6.7	-4.6	-2.9	-2.4
Structural Primary Balance	-3.6	-1.8	0.3	2.0	2.4
EDP Ceiling for Underlying General Government Balance	-8.6	-7.5	-5.1	-2.9	n.a.
Debt Ratio (end-year)	117.6	123.3	119.4	115.5	110.8
(€ billions)					
Underlying General Government Balance	-12.46	-12.50	-7.55	-3.97	-3.19
Underlying General Government Primary Balance	-6.33	-4.26	0.95	4.95	5.99
General Government Debt (end-year)	192.5	207.0	208.2	209.7	209.5

The **underlying general government balance** is the overall balance (net lending) of the government sector excluding once-off items. It does not include commercial state sponsored bodies. The **underlying general government primary balance** is government lending excluding interest payments on consolidated government liabilities and excluding once-off items. The **structural budget balance** is the cyclically adjusted budget balance excluding once-off items. The **structural primary balance** also excludes interest payments on consolidated government liabilities.

Source: Department of Finance (2013) Stability Programme Update, April: Table 8, Table 10, Table 16, Table A4

Table 2: Selected Economic Growth Forecasts

Economic Growth, % change	2011	2012	2013	2014	2015	2016
Real GDP	2.2	0.2				
Real GNP	-1.6	1.8				
Real GDP Growth Forecasts						
IMF (June 2013)			1.1	2.2	2.7	2.7
EU Commission (May 2013)			1.1	2.2	2.8	n.a.
DOF (April 2013)			1.3	2.4	2.8	2.7
CBI (July 2013)			0.7	2.1	n.a.	n.a.
NERI (June 2013)			1.0	1.2	1.8	3.0
ESRI (May 2013)			1.8	2.7	n.a.	n.a.
Average Forecast			**1.2**	**2.1**	**2.5**	**2.8**
Output Forecasts (Department of Finance)						
Real GDP			1.3	2.4	2.8	2.7
Real GNP			0.8	1.8	2.0	2.0
Nominal GDP			2.6	3.8	4.2	4.2

Sources: CSO (June 2013) National Accounts; Department of Finance (August 2013) Monthly Economic Bulletin; Nevin Economic Research Institute (Summer 2013)

Table 3: Selected Labour Market Forecasts

Employment Growth, % change	2013	2014	2015	2016
DOF	0.4	1.1	1.3	1.4
NERI	0.0	0.2	0.6	1.6
Unemployment Rate				
DOF	14.0	13.3	12.8	12.3
NERI	14.4	14.0	13.3	12.5
ESRI (Recovery Scenario)	14.0	13.4	11.8	10.6
ESRI (Delayed Adjustment Scenario)	13.9	13.8	12.9	13.5
ESRI (Stagnation Scenario)	14.1	13.1	12.5	13.4

Sources: Department of Finance (August 2013) Monthly Economic Bulletin; Nevin Economic Research Institute (Summer 2013); Economic and Social Research Institute (July 2013)

1.2 Fiscal Policy and the Fiscal Multiplier

6. TASC's analysis provides a strong evidence-base for arguing that the bulk of the overall adjustment in Budget 2014 should be achieved through revenue measures, alongside counter-balancing investment by the ISIF.

7. A base-line adjustment of €3.1 billion in discretionary fiscal consolidation (net) has been identified for Budget 2014 (DOF, April 2013)[4]. €3.1 billion was endorsed as appropriate by the Irish Fiscal Advisory Council (IFAC) in its Fiscal Assessment Report[5]. On the other hand, €3.1 billion was criticised as too high by the Nevin Economic Research Institute's (NERI) Quarterly Economic Observer[6]. NERI has proposed an alternative budgetary strategy involving €2 billion in consolidation to be supplemented by an off-the-books investment stimulus of €1.5 billion.

8. The re-engineering of the IBRC promissory notes in February 2013 improves Ireland's underlying general government balance by just under €1 billion in 2014. Consequently the EDP ceiling for

2014 can be achieved with a substantially lower adjustment than the €3.1 billion base-line. Indeed the 5.1 per cent figure is itself a politically agreed figure, not based on empirical studies.

9. There is a strong public interest in controlling the deficit and national debt, not least to limit intergenerational inequality. Ireland needs to restore stability, creditworthiness and sustainability to the public finances. The Fiscal Council cites a number of arguments for frontloading the adjustment. These include enhanced creditworthiness, debt sustainability, and intergenerational fairness in terms of the burden of future debt interest repayments. The Council also expresses concern that a large debt overhang could act as a drag on long-run growth. In addition, and notwithstanding the European Central Bank's Outright Monetary Transaction (OMT) commitments, the euro area still lacks a sovereign lender of last resort capable of and willing to short circuit a developing bad equilibrium of escalating bond yields in the sovereign bond markets. This acts as a constraint on the set of feasible fiscal stances.

10. On the other hand, the larger the budgetary adjustment that is made, the greater will be the impact in terms of reduced domestic demand, lower short-run growth, and higher unemployment. Once it is foregone, wasted potential output and employment cannot be recovered and the economy's year-on-year potential to generate economic output is permanently reduced. There are 'hysteresis' effects associated with long-term unemployment which can become structural within the economy and which can permanently reduce output potential. The economy is a complex system. Short term losses can be 'sticky' and there is no reason why an economy need bounce back to a given equilibrium point. Instead, the future trajectory of Ireland's economy could follow a number of different paths. Accumulated damage in terms of lost human capital, business closures, emigration, job losses, etc. can permanently reduce the long-term potential output of the economy. For example, a business that is 'hanging on' and eventually goes under during a prolonged recession cannot easily be restored once the economy recovers.

11. The 'fiscal multiplier' measures the effect of Government's tax and spending changes on overall economic growth. The size of the multiplier therefore has consequences for total employment and for deficit and debt sustainability. The smaller the multiplier the less costly 'austerity' will be for growth, for employment and for debt sustainability. The exact size of the multiplier is difficult to estimate in practice and is highly context dependent. Most empirical studies on fiscal multipliers to date have themselves been limited in scope and therefore context dependent. However, fiscal multipliers are likely to be higher than normal during recessions, where there is slack in the economy, and where there is high unemployment. For example, Rendahl[7] (2012) estimates multipliers rising to 1.5 where the unemployment rate exceeds 8 per cent. Multipliers also tend to be higher where interest rates are fixed (e.g. because monetary policy is decided exogenously, such as in the Euro zone) or where interests rate are already at or close to zero. Low interest rates

reduce incentives for private sector lending and this can generate a liquidity trap in the economy. Banks may simply choose not to lend. In this case government spending will not crowd out private sector spending. Similarly, multipliers will be larger where there are credit constraints and where the household and corporate sectors are attempting to deleverage. Finally, there is evidence that multipliers are higher when fiscal consolidation is simultaneously being pursued by the consolidating country's main trading partners. Gains in the form of reduced domestic demand for imports will be offset by the trading partner's own reduced demand for the country's exports. All of these worsening factors, identified by empirical evidence, are present in Ireland's case, which gives a very strong basis to believe the multiplier effect is currently higher than normal.

12. Recent empirical work by the IMF (2012) estimates that fiscal multipliers are much higher than had been thought prior to the Great Recession[8]. Specifically, the IMF estimates suggest the impact of discretionary fiscal consolidation is large, negative and statistically significant with the fiscal multiplier ranging between 0.9 and 1.7. The IMF results suggest that austerity is more damaging to the economy than was previously understood, and far higher than was assumed by the IMF itself. The IMF finds a strong negative relationship between fiscal consolidation and growth forecast errors. This may have implications for the reliability of growth forecasts in Ireland and elsewhere. In general the Keynesian framework has held up well empirically during the crisis while the negative effects of fiscal cutbacks appear to have been seriously larger than previously understood by policy makers. The pro-cyclical fiscal policies being pursued at a European level have therefore amplified and worsened the European recession. Co-ordinated austerity in a recession appears to be highly damaging, particularly where the tightening of fiscal policy is not accompanied by a loosening of monetary policy, and where households and businesses are liquidity constrained (e.g. due to high debt and/or the absence of bank lending).

13. A recent IMF working paper (IMF, 2013a) has attempted to provide a general framework for assessing the output and debt dynamics of an economy undertaking multi-year fiscal adjustments. The authors cast doubt on recent claims of underestimated multipliers. In addition, they suggest that for a highly-indebted economy undertaking large multi-year fiscal consolidation, high multipliers do not always argue against front-loaded adjustment. However, they also argue that the case for more gradual or back-loaded adjustment is strongest when hysteresis effects are in play, but that it needs to be balanced against implications for debt sustainability. This analysis reinforces the need for a lender of last resort at Euro area level in order to forestall threats to debt sustainability arising from excessive borrowing costs.

14. The Department of Finance appears to use a fiscal multiplier of about 0.5 in its growth forecasting models. Ireland is a small open economy with a very high import to GDP ratio. This may well suggest fiscal multipliers are indeed lower in Ireland than in other countries and, if true, would be

an argument in favour of frontloading the fiscal adjustment. In this context it might be inappropriate to compare multipliers in Ireland with those of large closed economies. However, recent studies indicate that such a low multiplier may be too low. There is a wealth of recent evidence on fiscal multipliers for small sub-national regions within much larger federations, for example individual states in the United States, Canada and Germany. These states provide a far better basis of comparison with Ireland than large closed economies because they operate as small economies that are also extremely open. These states also operate under similar conditions to Ireland in so far as monetary policy is effectively determined exogenously. Recent empirical research on sub-national fiscal multipliers provides estimates of between 1.5 and 2.5 (for example Nakamura et al., 2011; Acconcia et al., 2011; Shoag, 2011)[9]. The implication is that the chosen fiscal stance has a major effect on economic growth and employment, even for small open economies like Ireland. Therefore the fiscal multiplier may be much higher than the Department of Finance estimates, with profound consequences for the social and economic impact of austerity measures.

15. TASC's analysis is that the base-line adjustment of €3.1 billion in Budget 2014 is too high. Instead, a three-part adjustment package is proposed, comprising no further cuts to public spending beyond the Haddington Road Agreement savings (€350 million), compensatory investment of €1.5 billion from the ISIF, and the balance of the adjustment to be made from increases in tax revenue. Combined with carry forward of property tax and other measures from last year (totalling €600 million), TASC proposes a further €1.75 billion in new tax measures. This would provide a total adjustment of €2.7 billion, counter-balanced by €1.5 billion of increased investment. Fiscal consolidation measures equivalent to €2.7 billion (net) are described in Section Two.

16. Discretionary fiscal consolidation of this scale will have a substantial contractionary effect on growth and employment particularly in the short-run. A narrow focus on the level of deficit reduction in 2014 should therefore be seen as misguided. Ireland has the lowest level of investment in the EU as a proportion of GDP. This has negative ramifications for Ireland's future productive capacity and growth potential. Hence the importance of an investment stimulus using the Ireland Strategic Investment Fund (ISIF).

17. The ISIF is to be funded using €6.4 billion from the National Pension Reserve Fund. It is proposed that €1.5 billion from the ISIF be allocated for targeted strategic investment in 2014. Measures should specifically target areas that enhance the economy's productive and growth capacity and address infrastructure deficits and structural problems in the skills base of the labour force. Projects should be selected based on their high potential to contribute to the economy's ability to generate long-term growth. Examples of schemes include investment in next generation

broadband infrastructure in collaboration with the private sector; renewable energy sources and infrastructure; water infrastructure; retro-fitting of energy efficient buildings; public transport; and primary healthcare facilities; as well as investment in human capital through the funding of education and training schemes targeted at the long-term unemployed.

1.3 Taxes, Social Contributions and Public Spending in Ireland and the EU

18. Eurostat (2013) data shows that at 28.9 per cent Ireland's ratio of combined tax and Social Security Contributions (SSCs) to GDP was the sixth lowest in the EU in 2011. This ratio is far lower than the weighted average for the EU (38.8 per cent) and the weighted average for the seventeen Euro area countries (39.5 per cent).

19. The Fiscal Council (2012) have attempted to develop a hybrid measure of Ireland's fiscal capacity in order to reflect the diminished fiscal capacity of the proportion of GDP in excess of GNP. By this measure Ireland's tax and SSC ratio is approximately 33.0 to 33.5 per cent – over 5 percentage points below the weighted EU average. Eurostat's (2012) description of Ireland as a low tax and SSC country therefore appears to be strongly supported by the data. The main reasons why Ireland is a 'low tax regime' are the very low levels of Social Security Contributions in Ireland, the relatively low levels of local government taxation and higher-than-average levels of tax expenditure.

20. Consumption taxes are by and large the most regressive taxes. The Implicit Tax Rate (ITR) on consumption is actually higher than the EU average. The VAT increases in Budget 2012 will have further increased the ITR on consumption. On the other hand, both labour and capital are taxed to a substantially lower extent than European averages according to both indicators (see Table 4 and Table 5).

21. If EU averages are taken as a benchmark, notwithstanding the tax measures undertaken in Budget 2012 and Budget 2013, Eurostat data suggests further scope for increasing taxes on property, on capital and business income, and on capital stocks (see Table 4). The largest differential between Ireland and the EU is for employer SSCs. Employer SSC accounted for just 3.5 per cent of GDP in Ireland in 2011 compared to a weighted EU average of 7.3 per cent of GDP (the weighted Euro area average was 8.2 per cent of GDP). To put the scale of this disparity in context the differential between Ireland and the average for the rest of the EU is greater than the combined fiscal adjustment of €5.1 billion scheduled for Budget 2014 and Budget 2015.

Table 4: Tax Revenues (including Social Security Contributions) in Ireland and the EU

		2006	2007	2008	2009	2010	2011
Total (% GDP)	**Ireland**	**32.1**	**31.6**	**29.8**	**28.3**	**28.3**	**28.9**
	EU-27	39.5	39.4	39.3	38.4	38.3	38.8
	Euro-17	40.0	40.1	39.6	39.1	39.0	39.5
Main Categories (% GDP)							
Taxes on Consumption	**Ireland**	**11.5**	**11.3**	**11.0**	**10.2**	**10.4**	**10.1**
	EU-27	11.1	11.0	10.9	10.7	11.1	11.2
	Euro-17	10.9	10.8	10.6	10.5	10.8	10.8
Taxes on Labour	**Ireland**	**10.4**	**10.8**	**11.3**	**11.7**	**11.7**	**12.1**
	EU-27	19.3	19.1	19.6	20.0	19.6	19.7
	Euro-17	20.3	20.1	20.6	21.0	20.8	20.9
Taxes on Capital	**Ireland**	**10.2**	**9.5**	**7.5**	**6.3**	**6.3**	**6.7**
	EU-27	9.2	9.3	8.9	7.8	7.8	8.0
	Euro-17	8.9	9.2	8.6	7.7	7.5	7.9
Selected Sub Categories (% GDP)							
Taxes on Capital Stock/Wealth	**Ireland**	**3.1**	**2.8**	**2.2**	**2.0**	**2.0**	**2.2**
	EU-27	2.9	2.8	2.8	2.7	2.5	2.6
	Euro-17	2.6	2.6	2.4	2.5	2.3	2.4
Corporate Income Tax	**Ireland**	**3.9**	**3.6**	**2.9**	**2.4**	**2.5**	**2.4**
	EU-27	3.3	3.3	3.0	2.2	2.4	2.5
	Euro-17	3.2	3.3	2.9	2.0	2.2	2.4
Taxes on Capital and Business Income	**Ireland**	**7.1**	**6.6**	**5.3**	**4.4**	**4.3**	**4.5**
	EU-27	6.3	6.5	6.1	5.2	5.2	5.4
	Euro-17	6.3	6.6	6.2	5.2	5.2	5.4
Taxes on Property	**Ireland**	**0.7**	**0.7**	**0.8**	**1.2**	**1.2**	**1.2**
	EU-27	2.3	2.2	2.2	2.0	2.0	2.1
	Euro-17	1.9	1.9	1.7	1.7	1.7	1.8
VAT	**Ireland**	**7.8**	**7.6**	**7.3**	**6.4**	**6.4**	**6.2**
	EU-27	7.0	7.0	6.9	6.7	7.0	7.1
	Euro-17	6.8	6.9	6.8	6.6	6.9	6.9
Environmental Taxes	**Ireland**	**2.5**	**2.5**	**2.5**	**2.4**	**2.6**	**2.6**
	EU-27	2.5	2.4	2.3	2.4	2.4	2.4
	Euro-17	2.4	2.3	2.2	2.3	2.3	2.3
Social Contributions (SSCs)	**Ireland**	**4.8**	**5.0**	**5.4**	**5.8**	**5.8**	**5.0**
	EU-27	12.4	12.2	12.5	12.9	12.7	12.7
	Euro-17	14.1	13.9	14.1	14.5	14.4	14.4
Employee SSCs	**Ireland**	**1.6**	**1.7**	**1.9**	**2.3**	**2.5**	**1.3**
	EU-27	3.8	3.7	3.8	3.8	3.8	3.8
	Euro-17	4.2	4.2	4.2	4.3	4.3	4.3
Employer SSCs	**Ireland**	**2.9**	**3.1**	**3.3**	**3.3**	**3.2**	**3.5**
	EU-27	7.1	7.1	7.2	7.4	7.3	7.3
	Euro-17	8.0	8.0	8.1	8.3	8.2	8.2

EU-27 figures represent the weighted average for the twenty seven European Union countries including Ireland; Euro-17 figures represent the weighted average for the seventeen Euro areas members including Ireland;
Source: Eurostat, Taxation Trends in Europe Annual Report 2013. Table 1, Table 6, Table 18, Table 22, Table 24, Table 26, Table 40, Table 44, Table 54, Table 56, Table 64, Table 66, Table 76.

Table 5: Where the burden falls: comparing Implicit Tax Rates[10] (ITRs) in Ireland and the EU, %

		2006	2007	2008	2009	2010	2011
Consumption	**Ireland**	**26.3**	**25.2**	**23.3**	**22.3**	**22.3**	**22.1**
	EU-27	19.9	20.1	19.7	19.1	19.7	20.1
	Euro-17	19.6	19.8	19.3	18.8	19.3	19.4
Labour	**Ireland**	**25.4**	**25.7**	**24.7**	**25.4**	**26.2**	**28.0**
	EU-27	35.7	35.9	36.1	35.4	35.4	35.8
	Euro-17	37.5	37.8	37.9	37.3	37.4	37.7
Capital							
	Ireland	**21.8**	**19.4**	**17.2**	**15.6**	**14.0**	**-**
	EU-27	-	-	-	-	-	-
	Euro-17	30.4	30.9	29.2	28.3	27.4	28.9

All non-Irish figures represent weighted averages; not all EU countries report data for the implicit tax rate (ITR) on capital and therefore the ITR shown for capital represents the Euro area. Source for Capital ITRs: Eurostat (2012), Taxation Trends in the European Union 2012: Table 77, Table 78, and Table 79. Source for Consumption and Labour ITRS: Eurostat (2013) Taxation Trends in the European Union 2013: Table 81, and Table 82

22. Table 6 compares IMF (2013b) forecasts for total government revenue as a proportion of GDP over the next five years in Ireland and the EU. The forecasts show that under current budgetary policies Ireland will remain a low tax jurisdiction according to Eurostat definitions.

Table 6: Government revenue forecasts, % GDP

	2013	2014	2015	2016	2017	2018
Ireland	34.0	34.4	34.3	34.2	34.0	34.1
EU-26 (average)	42.4	42.9	42.8	42.6	42.5	42.4

Source: IMF (2013b) World Economic Outlook, April

23. Examining the evidence, there is little scope for discretionary consolidation on the public spending side. IMF (2013b) forecasts suggest that by 2018, under current budgetary policy, primary public spending (i.e. not including debt interest repayments) will have fallen to the second lowest level in the EU as a proportion of GDP. In the medium term, Western European standards of public services and supports for the vulnerable are only attainable if Irish society is willing to maintain Western European levels of public spending. Redistributive tax policies, the social programmes underpinning the welfare state, and free healthcare and education, all mitigate the inequalities of risk and wealth generated by the market and are important pillars supporting social cohesion. TASC's analysis is that there should be no decrease in public spending, beyond the savings from the Haddington Road Agreement, with any other efficiency savings redistributed within public spending, especially to support social welfare and other vital programmes.

Table 7: Public spending forecasts, % GDP

Primary Expenditure	2013	2014	2015	2016	2017	2018
Ireland	37.3	34.5	32.3	31.6	30.9	30.6
EU-26 (average)	43.8	44.1	43.2	42.5	41.9	41.6

Source: IMF (2013b) World Economic Outlook, April; NERI (2013) Quarterly Economic Observer, Summer

Section Two

2.1 General Proposals for Budget 2014

24. TASC's analysis is that any further cuts to public expenditure will be false economies that will embed higher structural long-term unemployment, poverty and inequality, as well as generating higher future costs to the public finances. The evidence clearly shows that an economically efficient, equitable budget can be achieved by making the necessary level of deficit-reduction by adjustments to taxation.

25. Closing the deficit in the public finances can be achieved in a variety of different ways and there is no evidence that the Government is constrained by the troika in terms of choosing any credible combination of tax increases and public spending cuts. The only external constraints are that the Government must meet its EDP targets and that lenders must see the fiscal adjustment as feasible. As TASC argued in advance of Budget 2013 (TASC, 2012), the Government has total freedom to choose what portion of the burden of the adjustment is carried by different sections in society.

26. There remains a substantial deficit in the public finances. However, Ireland's public spending ratio in GDP terms is still only middle of the pack by EU standards. On the other hand, where Ireland is out of line with the EU is in its low ratio of tax and social security contributions as a proportion of GDP. Given this context, and the disproportionate importance of public services and social transfers for lower income groups, TASC is proposing a very different composition of adjustments to that outlined by the Department of Finance in its Stability Programme Update. The proposed set of adjustments (net) amounts to €2.7 billion. The composition of these adjustments is designed to protect the public services on which vulnerable people rely and to protect as much as possible the incomes and living standards of low and middle income groups. TASC's proposed measures for Budget 2014 are outlined in Table 8. A consolidation of €2.7 billion will have a substantial contractionary effect on growth and employment. However, the proposed measures should be seen in conjunction with the proposed investment stimulus of €1.5 billion in 2014 using funds drawn from the ISIF to off-set some of the contraction to the economy.

Table 8: TASC's Proposed Fiscal Adjustments for Budget 2014[11]

	No.	Specific Proposal	Notes and References to Parliamentary Questions[12]	2014 Yield
Revenue Measures				**(€m)**
Wealth/Wealth Transfer/Passive Income				
	1	Introduce an annual 0.40% tax on net assessable household wealth with an allowance set at €1 million	See McDonnell (2013)	150.0+[13]
	2	Reduce the level at which persons and companies may claim interest repayments against tax for residential rental properties from 75% to 40%	€157 million is an underestimate as it only includes claims from individuals and not companies *(14459/13)*	157.0+
	3	Limit the Business and Agricultural Reliefs for Capital Acquisition Tax (CAT) by reducing the discount on market value before tax is calculated from 90% to 70%. Introduce a combined €3.0 million ceiling on the qualifying amount for these reliefs	*(42279/12)*	50.0
	4	Increase the rate of Capital Acquisitions Tax from 33% to 35%	*(20062/13; 36056/13; 19807/13))*	18.0
	5	Increase the annual charge on the value of trust assets from 1% to 2% for the purposes of Discretionary Trust Tax	*(36378/13)*	0.8
	6	Abolish relief for Employee Share Ownership Trusts	Yield is based on a 2009 estimate *(20069/13)*	1.3
			Sub-Total	**377.1+**
Pension Related Tax Reliefs				
	7	Confine tax relief to the standard rate of 20% in respect of pension contributions to occupational pension schemes, retirement annuity contracts and personal retirement savings accounts and confine tax relief for the public service pension related deduction to the standard rate of 20%	*(See 36006/13 and 36745/13)*	560.0
	8	Reduce the tax exemption for lump sum pension payments to €80,000 with the balance taxed at the marginal rate of income tax	€20 million is an underestimate as it does not include the yield from the private sector *(See 36743/13)*	20.0+

	No.	Specific Proposal	Notes and References to Parliamentary Questions[12]	2014 Yield
			Sub-Total	**580.0+**
Labour				
	9	Introduce a third band of employer's PRSI contributions at 17% charged on the portion of salaries above €100,000	*(36748/13; 36749/13; 36750/13)*	162.0
			Sub-Total	**162.0**
Excises				
	10	Introduce tax excise duty on saturated fat, added sugar and added salt	See Murray and Collins (2012)[14]	188.1
	11	Increase the tax excise duty on a packet of 20 cigarettes by €0.50 with a pro-rata increase on other tobacco products	*(See 24148/13)*	77.5
	12	Increase the tax excise duty on a bottle of wine by €0.50	*(See 8841/13)*	30.0
	13	Increase tax on betting shop profits to 3%	*(See 38297/12)*	67.5
	14	Introduce a tax on online gambling of 3%	*(See 38296/12)*	60.0
			Sub-Total	**423.1**
Environmental				
	15	Increase the existing carbon tax rate for all fuel types to €25 per tonne of CO_2	*(See TSG 12/23)*	104.0
	16	Implement the €200 car park tax originally introduced in Budget 2009 but never enacted	See Budget 2009	10.0+
			Sub-Total	**114.0+**
Miscellaneous				
	17	Increase audit, investigation and compliance resources by 125 qualified staff	Estimated cost of €6.5 million per annum to yield €100 million per annum *(See 42265/12)*	93.5
	18	Carry-forward effects from measures announced in previous Budgets	*(See 20073/13)*	600.0
			Sub-Total	**693.5**
Total Revenue Measures				**2,349.7+**
Expenditure Measures				**(€m)**
	19	Savings under the Haddington Road agreement		350.0
Total Expenditure Measures				**350.0**
TOTAL ADJUSTMENT				**2,699.7+**

2.2 Specific Proposals for Budget 2014

27. Taxes on property, passive income and wealth transfers have a number of advantages[15]. They are generally less damaging to economic growth and employment than other taxes. Tax breaks for non-productive assets such as houses and hotels distort investment away from more productive use and are therefore damaging to long-run growth. Intergenerational wealth transfer in particular runs counter to the principle of equity as it perpetuates economic inequality. TASC is proposing a number of reforms to Capital Acquisition Tax (CAT) for Budget 2014. Specifically:
    a. Increase the rate of CAT from 33 per cent to 35 per cent
    b. Amalgamate business relief and agricultural relief for CAT. Reduce from 90 per cent to 70 per cent the level of discount on market value provided by this relief before CAT is calculated. Introduce a €3.0 million ceiling on the qualifying amount for this relief.
    c. Increase the annual charge on the value of trust assets from 1 per cent to 2 per cent for the purposes of Discretionary Trust Tax

    In addition, there is a concern that CAT in its present form is too easy to avoid and potentially open to abuse. Consideration should be given to removing the exemption for spouses, albeit doing so in conjunction with the introduction of a tax free threshold for spouses, for example in excess of €1 million.

28. TASC is also proposing the introduction of an annual tax on net wealth. See McDonnell (2013) for a policy discussion on the advantages and disadvantages of introducing an annual net wealth tax. Finally, TASC is proposing a reduction on tax relief for passive (rental) income. Specifically, TASC proposes a reduction of the level at which individuals and companies can claim interest repayments against tax for residential rental properties from 75 per cent to 40 per cent

29. The Irish taxation system is characterised by a number of very generous pension related tax reliefs. The ESRI (2009) has estimated that 80 per cent of the benefits of pension tax reliefs in Ireland go to the top 20 per cent of earners. The system of pension tax reliefs is arguably the most regressive component of the tax system and in practice amounts to a form of social welfare for the better off. There is also little justification in equity or efficiency for exempting income windfalls from lump sum pension payments from taxation. TASC is proposing the following measures in these areas for Budget 2014:
    a. Confine tax relief to the standard rate of 20 per cent in respect of pension contributions to occupational pension schemes, retirement annuity contracts and personal retirement savings accounts and confine tax relief for the public service pension related deduction to the standard rate of 20 per cent
    b. Reduce the tax exemption for lump sum pension payments to €80,000 with the balance taxed at the marginal rate of income tax.

30. Certain economic activities impose costs (e.g. pollution) on the rest of society. In order to internalise the costs of these activities it is appropriate that they should attract higher rates of tax. Although consumption taxes tend to be regressive, consumption taxes are also generally less damaging to economic growth than taxes on production. Each of the proposed measures can individually be justified on public policy grounds. For example, as health promotion measures, TASC is proposing an increase in the excise on cigarettes as well as the introduction of a tax on saturated fat, added sugar and added salt. TASC is proposing that the following measures be introduced in Budget 2014:
    a. Introduce tax excise duty on saturated fat, added sugar and added salt (See Murray and Collins, 2012)
    b. Increase the tax excise duty on a packet of cigarettes by 50 cents with a pro-rata increase on other tobacco products
    c. Increase the tax excise duty on a bottle of wine by 50 cents
    d. Increase the tax on betting shop profits to 3 per cent
    e. Implement a tax on online gambling of 3 per cent
    f. Increase the carbon tax rate to €25 per tonne of CO_2
    g. Implement the €200 car park tax originally introduced in Budget 2009 but never enacted

31. The extremely low level of employer social security contributions in Ireland, at least by EU standards, has already been commented upon. Reform of employer PRSI should focus initially only on the portion of salaries above €100,000.
    a. Introduce a third band of employer's PRSI contributions at 17 per cent charged on the portion of salaries above €100,000

32. The ongoing process of restricting and eliminating tax expenditures should continue while all future Finance Bills and Budgetary Statements should clearly indicate the cost to the state in revenue foregone of all existing and new tax expenditures. See TASC (2012) for additional proposals regarding the reform of tax expenditures.

33. Finally, TASC continues to argue that all Budgets should be accompanied by an annual equality statement that is informed by an equality audit of the proposed package of measures. A full distributional analysis of the effects of the cumulative budgetary impacts should be published annually within six months of the budget.

Section Three

3.1 Future Budgets

34. The process of fiscal consolidation will continue beyond Budget 2014. TASC does not consider the Government's stated position that the taxation of labour should remain untouched to be sustainable. Nevertheless, great care is required when designing measures in order to minimise the impact on employment. In particular, taxes on low-income workers should be avoided where possible. Introducing a third rate band for employer PRSI targeted at those earning in excess of €100,000 is likely to be one of the least harmful options as well as being one of the most progressive. Reform of labour taxation should focus on the continued restriction and abolition of tax reliefs rather than on increases in the marginal tax rate.

35. As a more general point, the medium-term strategy should emphasise the reduction and eventual abolition of most tax reliefs and exemptions. Tax breaks tend to disproportionately benefit the better off and exacerbate inequality in the long-term. All tax breaks should be subject to a cost-benefit analysis, and to a sunset clause ensuring that they expire after three years unless they are renewed for a further three years by the Dáil following a positive cost-benefit analysis.

36. Broadening of the tax base should continue. This includes retention of the Local Property Tax and the introduction of equality proofed water charges that protect those on low incomes (see TASC, 2013). TASC supports the introduction of a Financial Transactions Tax (FTT) at the European level, and Ireland should join those EU states currently proceeding with an FTT. The principles of horizontal and vertical equity should inform all budgetary decisions and social solidarity demands greater steps to ensure that tax fugitives make a fair tax contribution. TASC has also long advocated equality proofing and equality auditing of all budgetary measures.

37. At a global level, TASC supports increased transparency in the reporting of activities of multinational companies and other entities, and the automatic exchange of information between tax authorities. Aggressive 'race to the bottom' tax competition is a zero sum game at international level. There is nothing to stop other countries engaging in different forms of this 'state-aid competition'. Relying on tax policy to attract foreign direct investment is not a sustainable industrial policy for Ireland in the long-run.

38. A final, but extremely important, consideration must be the systematic reversal of some of the most damaging cuts to public expenditure, including social protection, capital expenditure and other social programmes. As savings are achieved in one area, empirical cost-benefit research should be undertaken to identify areas where medium term savings could be achieved by reversing cuts sooner rather than later.

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Notes

[1] European Commission (June 2013) *Taxation trends in the European Union – Data for the EU Member States, Iceland and Norway*. Luxembourg: Publication Office of the European Union.
[2] Eurostat figures are used to allow direct comparison with other EU28 countries.
[3] The structural balance cannot be directly measured and different models and underlying assumptions will produce often wildly different estimates.
[4] DOF (2013) *Stability Programme Update*, April
[5] IFAC (2013) Fiscal Assessment Report, April
[6] NERI (2013) Quarterly Economic Observer, Summer
[7] Rendahl, P. (2012) *Fiscal Policy in an Unemployment Crisis*, University of Cambridge Working Paper, February
[8] IMF (2012) *World Economic Outlook*, October
[9] See for example Nakamura, E. and Steinsson, J. (2011) *Fiscal Stimulus in a Monetary Union: Evidence from US Regions*, NBER Working Paper 17391; Acconcia, A., Corsetti, G., and Simonelli, S. (2011) *Mafia and Public Spending: Evidence on the Fiscal Multiplier from a Quasi-Experiment*, CEPR Discussion Paper DP8305; Shoag, D. (2011) *The Impact of Government Spending Shocks: Evidence on the Multiplier from State Pension Plan Returns*, Harvard Working Paper
[10] Implicit Tax Rates (ITRs) measure the effective average tax take on different types of economic income or activities, i.e. on labour, consumption and capital. The ITR is the ratio between revenue from the tax type under consideration and the maximum possible base for the tax (Eurostat, Taxation Trends in the EU, 2012 Edition, p. 27).
[11] Table does not include investment related proposals
[12] Seven digit codes refer to written answers to parliamentary questions. TSG refers to the Tax Strategy Group
[13] This yield is likely to be conservative. The actual yield depends on the distribution of wealth in the population. See McDonnell, T. (Forthcoming, September 2013) *Wealth Tax: Options for its Implementation in the Republic Of Ireland*
[14] Murray, M. and Collins, M. (2012) *Modelling the Structure and Distributive Impact of a Fat Tax for Ireland*, Dublin Economics Workshop, Galway, October 2012
[15] For a fuller discussion of tax policy, the effects of different taxes, and taxation principles, see TASC (2012).