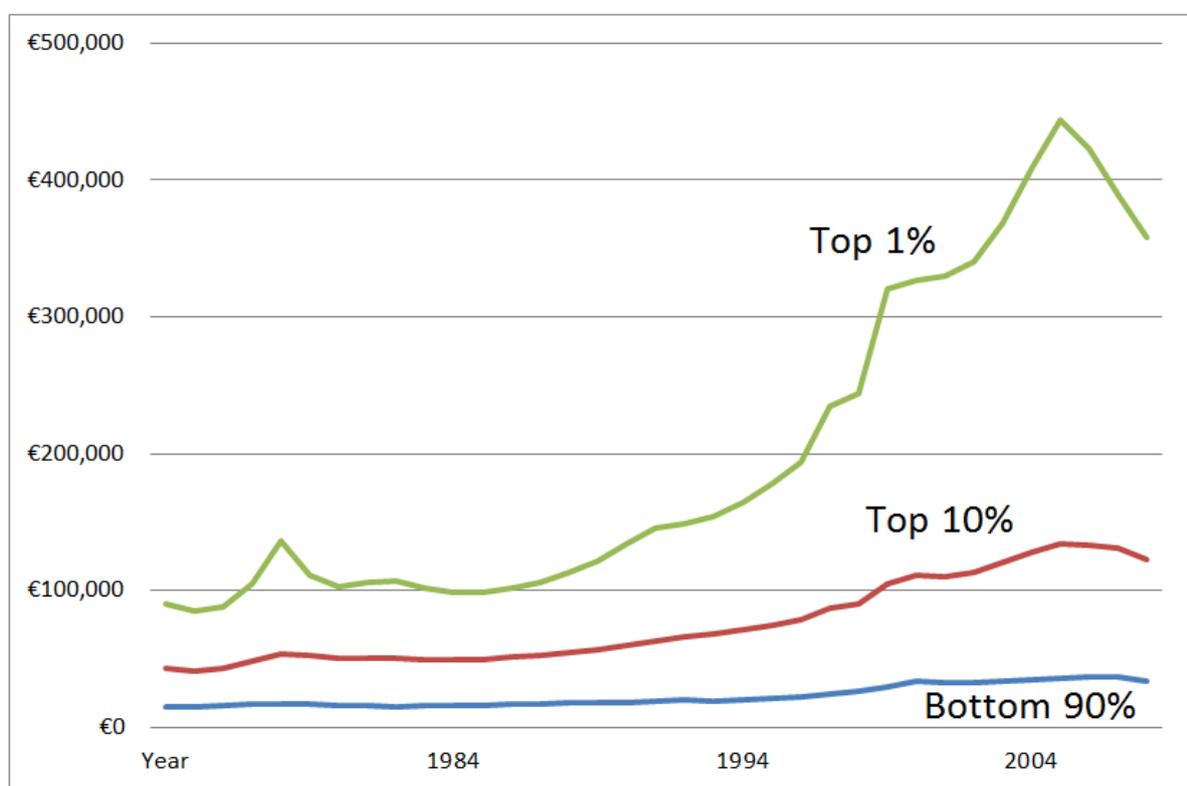


TASC Budget 2015 Commentary: *A Chance to Address Ireland's Inequality Problem*



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Executive Summary

Budget 2015 represents a turning point for the Irish economy. After six years of regressive budgetary policies, the Irish public finances permit a change of direction. To ensure recovery is felt across society, the best way for this Budget to “give something back” is through safeguarding health, education and other vital public services, as well as boosting job creation through investment and retraining opportunities.

Reforms are needed to tackle economic inequality, which has worsened throughout boom and bust, and which was a cause of the global crisis. Calls for tax cuts are growing louder but these do not represent an equitable or sustainable option. Ireland’s national debt is also dangerously high. In its commentary, TASC outlines a progressive way of achieving the three per cent deficit target, while adjusting taxation and public spending to reduce economic inequality. Likewise, the analysis shows it is possible to promote greater equality while creating jobs and protecting the public finances. TASC makes the following proposals for Budget 2015:

Policy	Yield (€m)	Cost (€m)
Pensions-related tax reform ¹	580	
Abolish health insurance tax relief ²	400	
Lower VAT by 1%		- 350
Fix Step effect in PRSI		- 25
Increase Personal Tax Credit by €200		- 260
48% tax on income above €100,000	365	
Expenditure increases		- 615
Water Charges	500	
Water Credits		- 100
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue ³	500	
Total	3,020	- 1,350
Net Adjustment	1,675	

Based on recent economic growth and other favourable circumstances, the budget can afford to take far less than the planned €2 billion out of the economy, while still meeting the deficit target in a progressive way.

TASC’s proposals for tax reform, alongside carry over measures from last year, amount to a €1,675 million net adjustment, comprising €1,060 million in tax increases and efficiency savings, combined with an additional €615 million of additional spending on health, housing and other vital services. In the full report, TASC provides alternative scenarios that allow for larger or small deficit reductions, depending on economic circumstances and the timeline for certain reforms.

Proposals

Baseline Adjustment (€1.2 billion yield): prior to Budget 2015, the Government is already in line for a yield of €500 million from Water Charges, €300 million in savings from carry over measures (e.g. Haddington Road agreement), while it is estimated that the refinancing of IMF loans will save €375 million.

¹ Calculated from TASC Budget 2014 submission

² The level of yield is conservative, based on the recent cap to this tax relief and lack of Revenue data on this cap’s effect.

³ TASC estimate based on August 2014 figures on Tax revenues ahead of profile

Water Credits (-€100 million cost) TASC's proposal is that people on low incomes should have all or most of their water charges cancelled out by credits, provided by Irish Water. People and families with special needs would also be protected.

Public Spending on Services, Transfers and Investment (-€500 to -€615 million cost): The alternative to tax cuts is a stabilisation of Ireland's tax base, and if there is scope to "give something back" it should be in the form of support to low income households, bolstering public services and public investment to support job creation. TASC's proposals allow extra funds to cover health, social housing, re-training and other targeted areas where more public spending is crucially needed.

Fix Step effect in PRSI (-€25 million cost) TASC has identified an inequitable 'step effect' in personal income taxation, which affects people on very low incomes so that someone on €19,000 has less take home pay than someone on €18,000. TASC's proposed refund scheme, operated by employers, would taper the onset of PRSI to address this technical anomaly at a cost of €25 million.

Increase Personal Tax Credit by €200 (-€260 million cost): While changes to tax rates and bands disproportionately benefit higher earners, an increase in tax credits of €200 would have the same benefit for a single earner on €25,000 or on €125,000: i.e. an extra €200 each.

Lower VAT by 1% (-€350 million cost): Reducing VAT by 1 percentage point would boost domestic consumption and help kick-start the economy, boosting the spending power of lower income households in particular.

Reform of Tax Relief (€980 million yield): Tax expenditures (tax breaks) play a very prominent role in the Irish tax system and are grossly inequitable. TASC proposes pensions-related tax reform (€580 million yield) and abolition of health insurance tax relief (€400 million yield).

48% Tax on Incomes above €100,000 (€365 million yield) Introducing a third rate of income tax on high incomes would improve equity, while increasing progressivity and flexibility in the tax system. It would affect just under 5 per cent of all people paying income tax.

As shown below, official data by income group shows that on average no tax payers paid more than 30 per cent of their income in income tax, which is far lower than the 41% higher rate. This is partially due to tax breaks. Similarly, even if the maximum rates of USC (7% or 10%) and PRSI (4%) are included, tax paid is still far less than the 52% marginal rate.

Preface

Three considerations frame TASC’s analysis of the context for Budget 2015.

Stable Tax Revenue

Firstly, there can be no going back to the unsustainable model of public finances that arose at the peak of the boom, where tax revenue was buoyed by increases in private debt, particularly debt related to the property market. This was inherently unstable and based on people borrowing from the future through mortgages and other debt. We are now in that future, and it clear that we will be paying the price of the boom for decades to come. It is therefore impossible to reverse all of the spending cuts and tax increases, without fundamental changes to the tax and social insurance system.

Alongside mortgage debt and other household and business debt that cripple the economy, the national debt currently stands at 122 per cent of GDP⁴ (end-Q1 2014). The Fiscal Compact commits Ireland to lowering this ratio, which, even with good GDP growth, will cost €5 billion or more of debt repayment from 2019, in addition to interest repayments on the remainder of the debt⁵. There is a real risk that post-election, there will be further regressive budgets cutting public services if the tax base is not secured now.

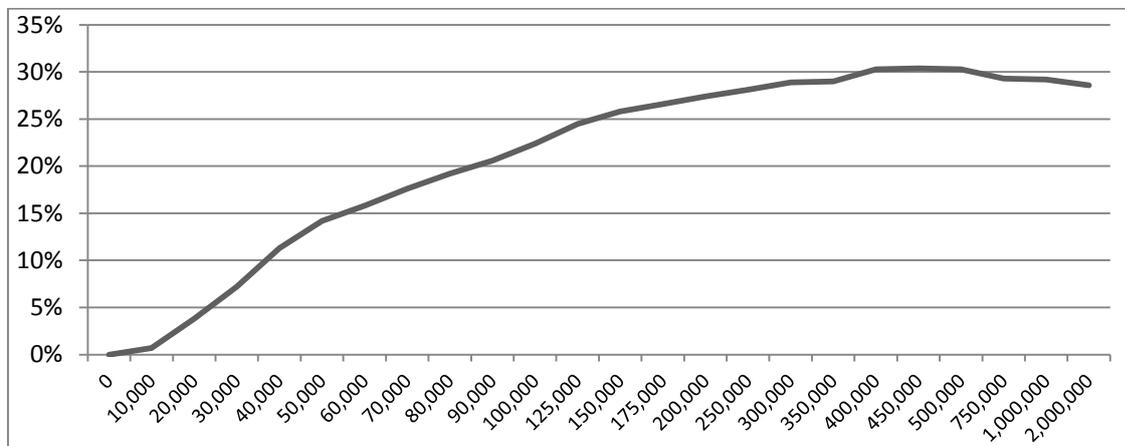


Chart: Average Income Tax paid by Gross Income Group (Revenue Data, 2013)⁶

⁴ CSO (July 2014) Government Financial Statistics

<http://www.cso.ie/en/releasesandpublications/er/gfsg/governmentfinancesstatisticsquarter12014/#.VBF8RsjdUk1>

⁵ Budget 2014: <http://budget.gov.ie/Budgets/2014/Documents/Economic%20and%20Fiscal%20Outlook%202014.pdf>

⁶ Parliamentary Question Written Response, 51353/13:

<http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/takes/dail2013120300055#WRC00350>

Sustainable Job Creation

Secondly, not only is it impossible to go back to the boom time, it is undesirable from society's perspective. The boom brought about greater economic inequality, with those with more economic power gaining a greater share of the benefits. Economic inequality has been widely recognised as the paramount issue facing the world's economies and a cause of the global crisis.

Increasing quality employment is key to tackling economic inequality. Much of the employment created during the boom was unsustainable. New business infrastructure and investment is needed to create real job opportunities. Likewise, now is the time to build the foundations for new models of public services – especially health, education and housing – that will deliver for all members of society.

A More Balanced Economy

Thirdly, a weight of evidence suggests that a more equitable distribution of income and wealth will lead to greater economic performance through stronger aggregate demand and more investment in SMEs. Ireland needs to use equality as a guiding principle to ensure a more socially just outcome and shared prosperity for all – including neighbourhoods and counties that have not seen any sight of economic recovery to date.

Budget 2015 is a tipping point, where the Government has more choices than in previous years, but some politically advantageous short-term decisions risk long-term negative consequences. The choices that are made will have an enormous bearing not just on the economy, but on the type of society we wish to live in.

In particular, there is a risk that political pressure for tax cuts and spending reversals, without strong analysis of their impact, will only benefit those who are already the most economically powerful. And when the unsustainability of these measures becomes apparent, everyone else will pay (directly and indirectly) through limited public services and a weaker economy providing fewer jobs and lower pay.

After six years of spending cuts, new taxes and new charges, people are now expecting, and the government is promising, "something back", particularly in the form of tax cuts. This is a risky strategy that will not lead to sustainable growth and will exacerbate persistent levels of economic inequality. If there is scope in the budget to give something back, it should be achieved through restoring and redirecting public expenditure and investment, rather than through tax cuts.

Section 1: Proposals for Budget 2015

TASC's analysis of taxation, *A Defence of Taxation*⁷, forms the basis of this budget submission. While accepting the target of reaching a budget deficit of no more than three per cent of GDP, the goal should be for public services, social transfers and public investment to be protected and if possible increased in Budget 2015.

It now appears to be the case that there is scope to have an adjustment significantly less than the originally planned €2.1 billion, with a number of already announced measures addressing the bulk of the necessary adjustment to public spending and taxation.

Specifically, water charges are expected to raise €500 million, carry-over of measures related to the Haddington Road Agreement are expected to lower public spending by €300 million and the recent announced attempt to repay Ireland's IMF loans early could reduce annual debt interest repayments by €375 million⁸. In addition, tax revenues for 2014 are, as of August 2014, 4.1 per cent ahead of profile⁹. TASC's conservative estimate is that additional tax revenue combined with over- and under-spending on different budget areas, allows for a net additional €500 million in tax revenue in 2015.

In total, the Government's baseline position equals €1.675 billion of adjustments. This may be sufficient to meet the three per cent of GDP deficit target (assuming economic growth in 2014 does deliver higher tax revenue and lower overall public spending)¹⁰.

The Government's Baseline Position

Given the available information and projections it seems possible to achieve an adjustment of **€1.675 billion** without any further tax increase or spending cuts.

	Yield (€m)	Cost (€m)
Water Charges	500	
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue¹¹	500	
Total	1,675	
Adjustment	1,675	

⁷ <http://www.tasc.ie/researchpolicy/projects/tax-policy/>

⁸ Irish Independent, 12th September 2014: <http://www.independent.ie/business/irish/deal-on-imf-bailout-loans-expected-to-save-us-about-15bn-noonan-30582082.html>

⁹ DoF Information Note, Exchequer Figures August 2014:

<http://www.finance.gov.ie/sites/default/files/Exchequer%20Returns%20end%20August%202014%20information%20note.pdf>

¹⁰ Also, a technical exercise of recalculating Ireland's GDP from 2014, using a new European standard that includes an estimate of the black economy, also has the side-effect of increasing what is represented by 3 per cent of GDP. That makes the deficit target easier to meet.

¹¹ TASC estimate based on August 2014 figures on Tax revenues ahead of profile

The €1.675 billion baseline is far from being a ‘neutral budget’. Even though these measures have already been announced, they represent a further €800 million in money that will be taken out of the economy from January 2015, with a contractionary effect on GDP.

Based on the assumption that all €1.675 billion will be needed to adjust tax and spending to meet the three per cent of GDP deficit target, the Government does not actually have scope to implement tax cuts or to increase spending without counter-balancing these measures (e.g. raising tax or spending in one place while reducing it in another). In this context, analysis of the likely distributional effects of these changes are essential, to avoid a worsening of economic inequality in Ireland.

TASC’s Budget Scenarios

Building on this baseline, TASC presents four scenarios for Budget 2015, based on the above plus the proposals and costings detailed in *A Defence of Taxation*. The rationale for presenting multiple scenarios is that, while the first scenario is preferable, the other scenarios allow for longer timeframes that may be required to abolish certain inequitable tax reliefs. Running through all scenarios is the goal of sharing economic prosperity more equally across Irish society.

Scenario 1 (preferred scenario): Accepting all recommendations in *A Defence of Taxation*, including detailed reductions in tax breaks, introducing water credits and allowing for targeted increases in funding for health, education and other public expenditure. This scenario represents a far more progressive way of achieving the three per cent deficit target, while adjusting taxation and public spending in favour of economic equality. (Adjustment: **€1.675 billion.**)

Scenario 1	Yield (€m)	Cost (€m)
Pensions Related tax reform¹²	580	
Abolish health insurance tax relief¹³	400	
Lower VAT by 1%		-350
Fix Step effect in PRSI		-25
Increase Personal Tax Credit (€200)		-260
48% tax on income above €100,000	365	
Expenditure increases¹⁴		-615
Water Charges	500	
Water Credits		-100
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue¹⁵	500	
Total	3,020	-1,350
Net Adjustment	1,675	

¹² Calculated from TASC Budget 2014 submission

¹³ The level of yield is conservative, based on the recent cap to this tax relief – the results of which is not yet published in Revenue income tax data.

¹⁴ Detailed in the following sections

¹⁵ TASC estimate based on August 2014 figures on Tax revenues ahead of profile

Scenario 2: A higher level of adjustment can be achieved (if required) with fewer reductions in tax breaks in 2015, and without cutting VAT, while still increasing public spending and introducing water credits. (Adjustment: **€1.995 billion.**)

Scenario 2	Yield (€m)	Cost (€m)
Pensions Related tax reform¹⁶	580	
Fix Step effect in PRSI		-25
48% tax on income above €100,000	365	
Expenditure increases		-500
Water Charges	500	
Water Credits		-100
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue¹⁷	500	
Total	2,620	-625
Net Adjustment	1,995	

Scenario 3: An even higher level of adjustment can be achieved, with fewer reductions in tax expenditure, and maintaining, rather than increasing, public expenditure. This demonstrates that even the originally mooted €2.1 billion budget adjustment could be achieved through progressive measures. Moreover, this scenario allows a process of strengthening of the tax base to begin in advance of Ireland's commitment (from 2019) to begin to pay down the national debt, which will require upwards of €5 billion per annum additional public spending. (Adjustment: **€2.495 billion.**)

Scenario 3	Yield (€m)	Cost (€m)
Pensions Related tax reform¹⁸	580	
Fix Step effect in PRSI		-25
48% tax on income above €100,000	365	
Water Charges	500	
Water Credits		-100
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue¹⁹	500	
Total	2,620	-125
Net Adjustment	2,495	

¹⁶ Calculated from TASC Budget 2014 submission

¹⁷ TASC estimate based on August 2014 figures on Tax revenues ahead of profile

¹⁸ Calculated from TASC Budget 2014 submission

¹⁹ TASC estimate based on August 2014 figures on Tax revenues ahead of profile

Scenario 4: Implementing the three key headline recommendations of *A Defence of Taxation*, is almost cost neutral. Combined with already announced measures and TASC’s water credits proposal this gives a lower adjustment level.

Adjustment: **€1.565 billion**.

Scenario 4	Yield (€m)	Cost (€m)
Lower VAT by 1%		-350
Fix Step effect in PRSI		-25
48% tax on income above €100,000	365	
Water Charges	500	
Water Credits		-100
Carryover (incl HRA)	300	
IMF loan refinancing	375	
Additional Tax Revenue ²⁰	500	
Total	2,040	-475
Net Adjustment	1,565	

Section 2: TASC’s Proposals in Detail

Baseline Adjustment (€1.175 billion yield)

TASC’s calculations assume that €500 million will be realised from Water Charges and a further €300 million in savings will be achieved from carry over measures, including the Haddington Road Agreement, leading to a base adjustment of €800 million. In addition, refinancing the IMF loans with cheaper credit from the global markets is set to deliver €375 million, for a total baseline adjustment of €1.175 billion.

Water Credits (-€100 million cost)

The latest survey data from the CSO shows that 26.9 per cent of households are experiencing deprivation (SILC 2012), for example the inability to adequately heat their homes or replace worn furniture. In this context, many people cannot afford any level of water charges. Nonetheless, an economically efficient system of water charging needs to have the maximum number of households included, to ensure water conservation and to put the public utility, Irish Water, on a sound financial footing.

TASC’s equitable proposal is that people on low incomes should have all or most of their water charges cancelled out by credits, provided by Irish Water. People and families with special needs would also be protected through the allocation of Water Credits. This would be administratively simple and would not require complex means-testing. Households would opt into the system of Water Credits by declaring their incomes and any other relevant circumstances (e.g. certain

²⁰ TASC estimate based on August 2014 figures on Tax revenues ahead of profile.

disabilities). More detail is available in TASC’s publication *Paying for Water: Equity, Efficiency and Sustainability*²¹.

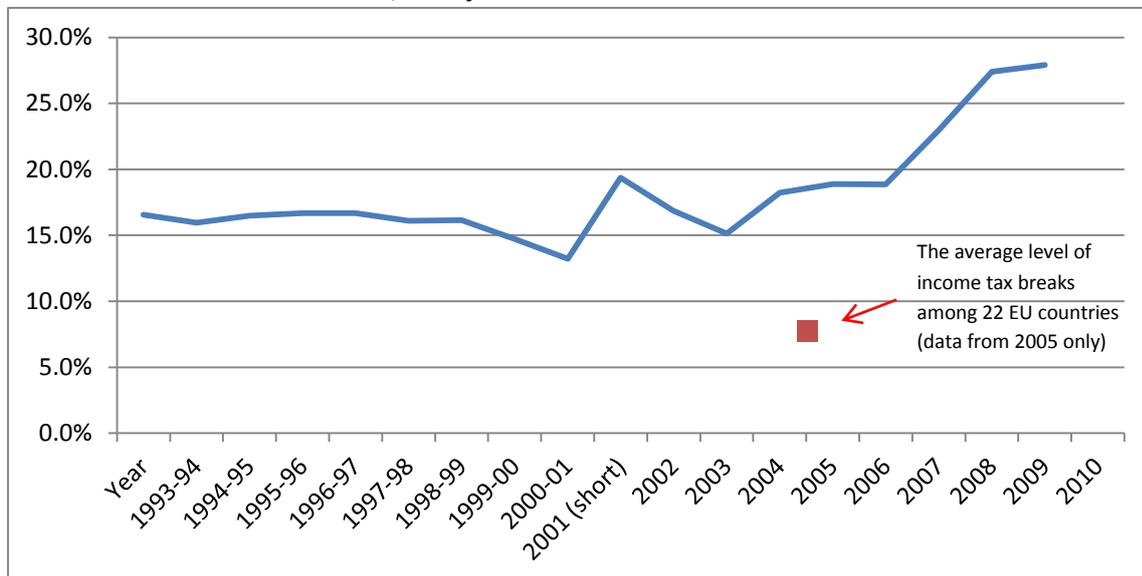
Pensions Related Tax Reform (€580 million yield) and Abolition of Health Insurance Tax Relief (€400 million yield)

Tax expenditures (tax breaks) play a very prominent role in the Irish tax system. Tax breaks should be seen in the same way as government spending programmes. Public spending in the form of tax expenditures tends to deliver larger benefits to higher income households. For example, reliefs that allow a tax deduction at the individual’s marginal rate of income tax are more valuable to, and will disproportionately benefit, those with the highest income tax rates. The ESRI has shown that 80 per cent of the benefit of pension tax reliefs goes to those in the top 20 per cent of the incomes distribution²².

The OECD’s *Economic Survey Ireland 2009* demonstrated that the average EU level of tax breaks in the income tax system (not including basic credits and allowances) was equivalent to 5.6 per cent of total taxation, whereas the equivalent number for Ireland was over three times greater at 18.3 per cent, based on 2005 Revenue data²³.

Chart 1 replicates this finding using the same method and both past data and more recent data. This demonstrates that not only has the use of tax breaks continued into Ireland’s recession, but the cost of funding tax breaks increased dramatically from 2008, due to the fall in overall tax revenue as the denominator.

Chart 1: Total tax breaks in income tax, as % of all tax revenue²⁴



²¹ <http://www.tasc.ie/researchpolicy/projects/water/>

²² ESRI (2009) *Pensions Policy – New Evidence on Key Issues* - <http://www.esri.ie/UserFiles/publications/20091124152236/RS014.pdf>

²³ OECD *Economic Survey Ireland 2009*, Table 2.5, page 60

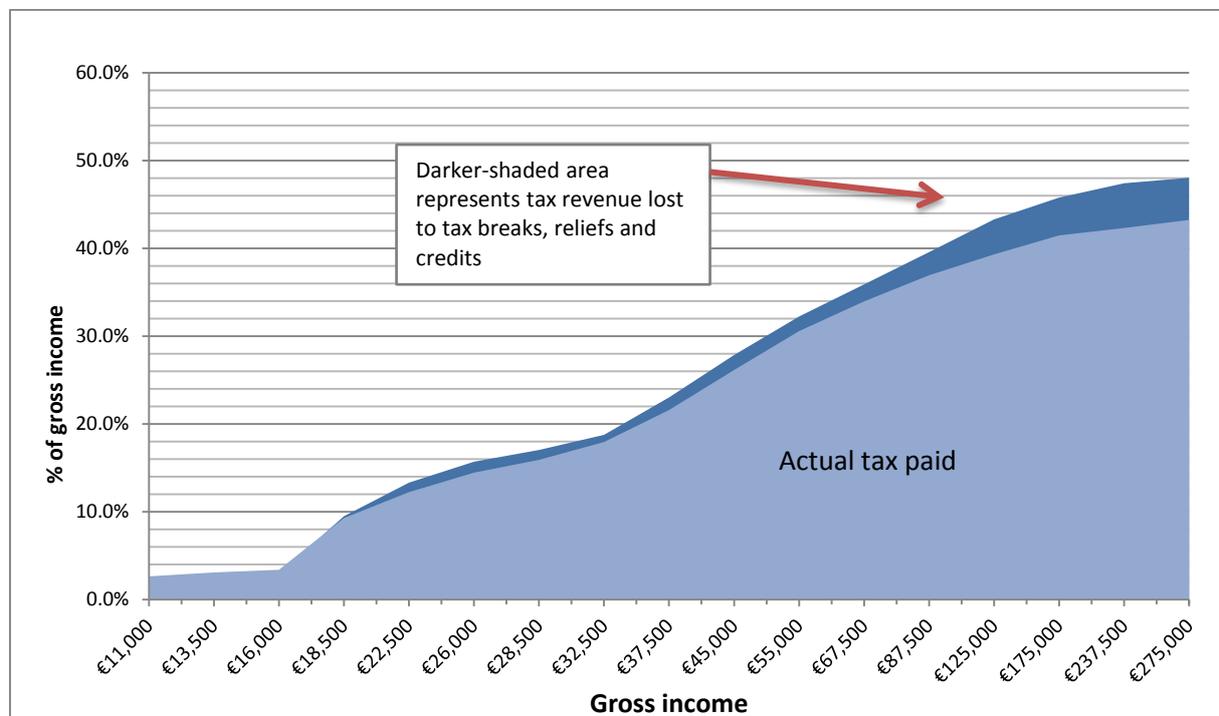
²⁴ Authors’ calculations replicating the OECD method. There is a break in the data at 2001, when Ireland moved to calendar years for tax purposes.

For Budget 2015, TASC proposes that pension-related tax reliefs should be reformed by confining 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. Tax relief for the public service pension deduction should also be confined to the standard rate of 20%. This would yield €560 million per year²⁵. Reducing the tax exemption for lump sum pension payments to €80,000 with the balance taxed at the marginal rate of income tax would yield a further €20 million per year²⁶.

In 2010, health insurance tax relief cost the Exchequer €697.9 million²⁷. However, the health insurance tax break was capped in Budget 2014, which should lower the future cost of this tax break. Nonetheless, it is grossly inequitable as it permits those with higher incomes to avail of faster access to health care, subsidised by a reduction in the overall tax base. As such, Budget 2015 should abolish this tax relief, with an estimated yield of €400 million.

In terms of the overall cost of tax breaks, these were equivalent to 27.9% of the value of total tax revenue, from all sources, in 2010. And that is counting only tax reliefs on income tax (not including those that are also eligible for use against corporation tax). The high level of tax expenditures explains why effective income tax actually paid is significantly lower than theoretical effective tax levels, as shown in Chart 2. The darker shaded area in the chart also shows the disproportionate benefit of tax breaks to those on higher gross incomes, which significantly reduces the progressivity of the income tax system.

Chart 2: Gap between theoretical and actual levels of income tax for a single person



²⁵ Parliamentary Questions: (See 36006/13 and 36745/13)

²⁶ Parliamentary Question (See 36743/13) is an underestimate as it does not include the yield from the private sector.

²⁷ Revenue Commissioners, *Revenue Statistical Reports 2011*

<http://www.revenue.ie/en/about/publications/statistical/archive/2011/income-tax.pdf>

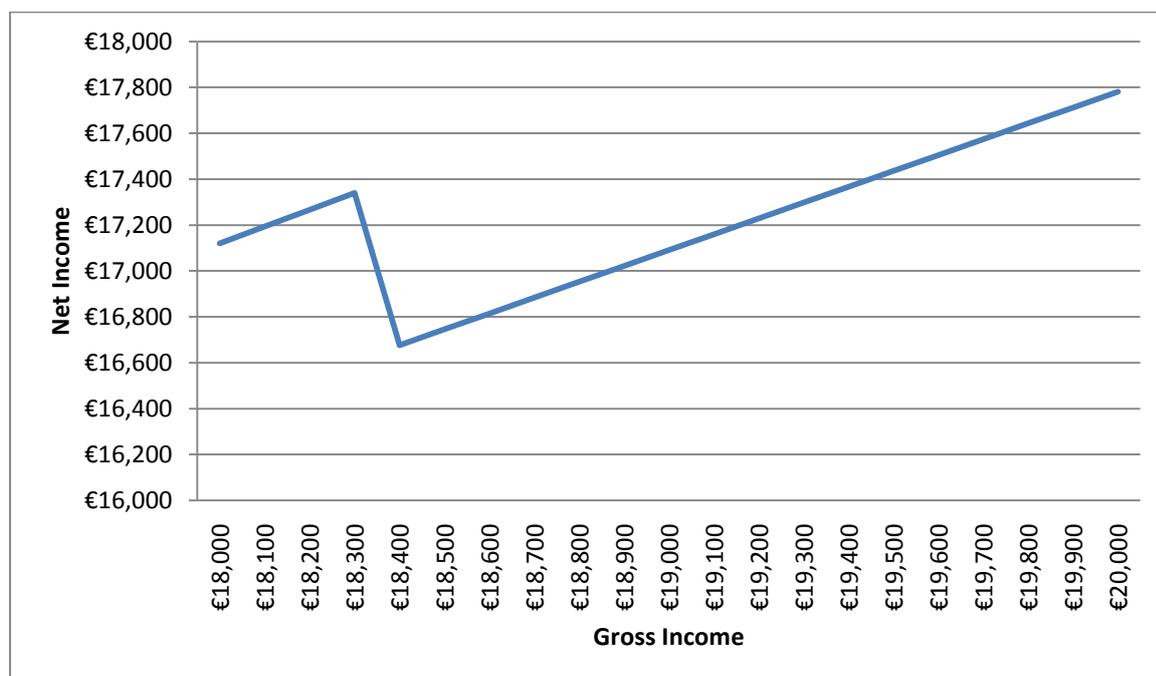
Fix Step effect in PRSI (-€25 million cost)

Rather than cut taxes for higher earners, Budget 2015 should remove a currently inequitable ‘step effect’ in personal income taxation, which affects people on very low incomes.

As Chart 3 shows, someone earning €18,304 pays an effective tax rate of 5.25%, someone who is paid one euro more will pay an effective tax of 9.25%, due to the onset of PRSI. This has the perverse consequence that a person earning €18,000 has higher take home pay than someone earning €19,000.

While the PRSI system currently exempts many part-time and low-paid workers from PRSI, the anomaly occurs because once someone is earning slightly more than the minimum wage full-time, he or she begins to pay PRSI on all earnings. As it stands, it effectively means that someone on close to the minimum wage needs a gross pay rise of over €1,000 to achieve any increase in their take-home pay. This is a disincentive to employers to increase wages, or for employees to accept extra hours of work. It is also a distinct barrier in the pathway from welfare to full-time employment.

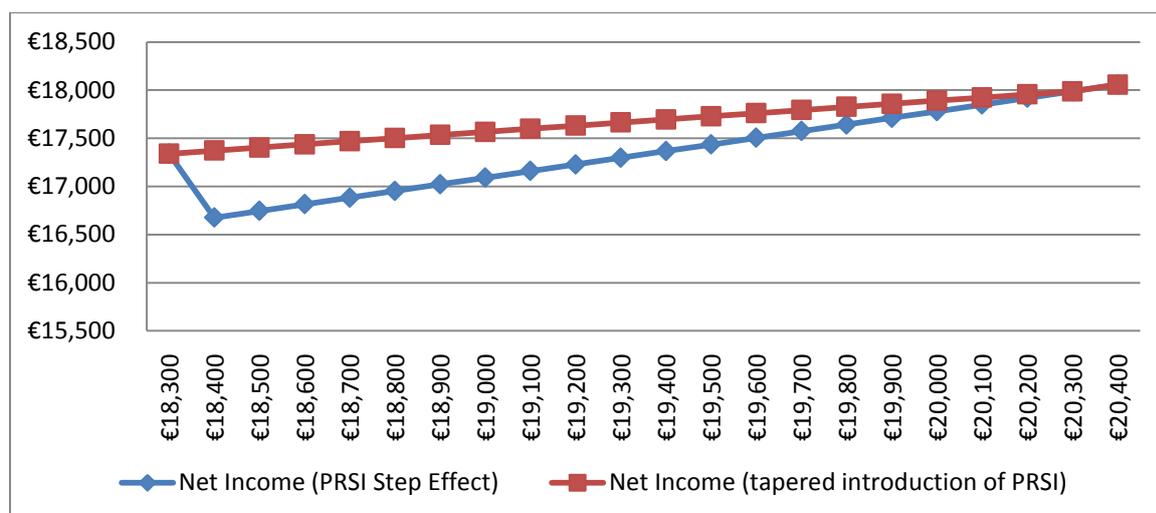
Chart 3: Change in net pay (blue line) as gross pay increases



With the current policy focus on increasing employment, and ensuring that work always pays better than welfare, it would make sense to remove this anomaly. In the context where 20.7 per cent of workers in Ireland are classified by the EU as ‘low paid’ (earning less than €12.20 per hour)²⁸ and given that many workers may not be getting full-time work sufficient to bring them outside of this anomaly in the tax system, this should not be seen as an isolated issue affecting only small numbers of people. TASC estimates that a refund scheme to taper the onset of PRSI, operated through employers, could address this technical anomaly with a cost of €25 million.

²⁸ NERI (2013) *Quarterly Economic Observer December 2013*
http://www.nerinstitute.net/download/pdf/neri_qeo_december_2013.pdf

Chart 4: PRSI Step Effect versus Tapering Introduction of PRSI on Low Earners



Increase Personal Tax Credit by €200 (-€260 million cost)

TASC’s analysis is that most suggested reductions in income tax will have least benefit to the lowest paid workers.

Whereas changes to the 41% rate would only benefit one in six income tax payers, the least worst option from an equality perspective would be to increase tax credits. This would provide the same value to all taxpayers who are earning sufficient income to pay more taxes than the credit increase. An increase of €200 would have the same benefit for a single earner on €25,000 or on €125,000: i.e. an extra €200 each. Nonetheless, this would cost €260 million, based on Tax Strategy Group figures that an increase of €100 in the PAYE Tax Credit will cost €130m for a full year.²⁹

Lower VAT by 1% (-€350 million cost)

In discussions on taxation, there is a significant focus on income tax, but it is also vital to look at the effect of consumption taxes which also affect income, redistribution, consumption and employment. Last year in Ireland, consumption taxes (including VAT, excise and some customs taxes), raised as much revenue as income tax. Of the 2.8 million people captured in the revenue data, 415,064 (14.5%) are earning less than €10,000 and thus do not pay USC, while 713,687 (25%) do not earn enough to pay any income tax. However all of these people, along with pensioners and the one million working-age adults who are unemployed or inactive, are still tax payers.

People on low incomes pay a much higher percentage of their income on indirect consumption taxes, whereas those on high incomes pay more of their gross incomes in direct personal taxation. Thus, increases in consumption taxes affect those on low incomes most. In Ireland, the standard rate of VAT (23%) is one of the highest in the world. Ireland, Greece, Finland Portugal and Poland are at 23% while only Denmark, Iceland, Sweden and Netherlands have a higher rate. VAT is the largest source of indirect tax with the average household paying €3,360 in 2010, or 6.3% of the average gross income.

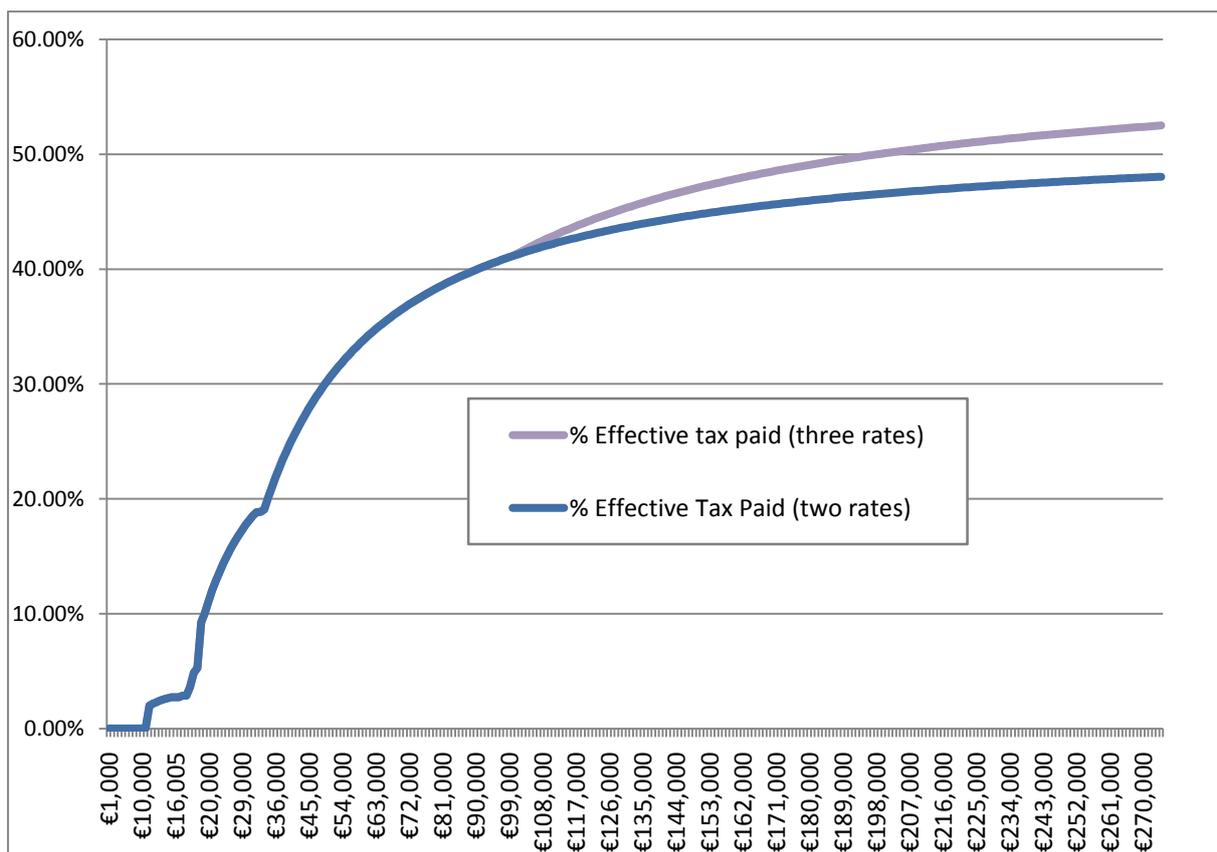
²⁹ Tax Strategy Group (2013) *Income Tax and USC*
<http://www.finance.gov.ie/sites/default/files/TSG%2013%2008%20Composite.pdf>

In 2012, the government increased the standard VAT rate by two percentage points. This raised €670 million in revenue in 2012. However, it also added to the downward pressure on domestic demand, as personal consumption fell by 6% between then and 2014. Domestic demand is rising and a reduction in VAT would help this recovery while alleviating an unjust distortion. Reducing VAT by 1 percentage point would boost domestic consumption and help kick-start the economy while boosting the income of the lowest decile of households, at a cost of €350 million (based on half the yield gained when raising VAT by 2 points).

48% Tax on Incomes above €100,000 (€365 million yield)

There is progressivity in the Irish income tax system because the proportion of gross income that is paid as income tax increases as income rises. However, given that there are only two rates of income tax (20% below €32,800 and 41% above) progressivity declines as incomes increase further. The point of decline begins at around €70,000 which is roughly around twice the average wage. At this point, the progressive increase of income tax as a percentage of actual tax paid rises increasingly much more slowly, as illustrated below.

Chart 5: Theoretical effective tax rates under two and three bands³⁰



Introducing a third rate of income tax would improve equity, while increasing progressivity and flexibility. A rate of 48% on incomes above €100,000 is illustrated in Chart 5. It would have no impact on earnings below €100,000, involve a steady increase in effective rates between €100,000 and

³⁰ Data from Deloitte Tax Calculator, with additional calculations by the authors

€200,000 and a much slower increase on gross incomes above that level. It would affect just under 100,000 income tax payers, which is less than 5 per cent of all income tax payers.

The Revenue Commissioners advised the Tax Commission that a third rate of tax is feasible, subject to an appropriate lead-in period being provided.³¹ Historically Ireland had more than two tax rates as set out in the table below. This shows the real opportunity to introduce a third rate of income tax to be applied on the portion of taxable incomes in excess of €100,000, without altering the existing income tax rates or bands. The Revenue Commissioners estimate the full year yield to the Exchequer, estimated by reference to 2013 incomes, of the introduction of the new income tax rates of 48%, 49% or 50% would be of the order of €365 million, €415 million and €470 million respectively³².

The introduction of significantly higher rates of income tax on high gross incomes is almost certainly necessary to stem the rise of income inequality in Ireland. Introducing such a change in Budget 2015 would provide the Government with one source of funds to allow tax cuts in other areas without undermining the sustainability of the national finances.

Year	Number of rates	Intervals	Gross income share of top 10%	Gross income share of top 1%
1977	6 rates	20%, 25%, 35%, 45%, 50% and 60%	27.3%	5.6%
1979	5 rates	25%, 35%, 45%, 50% and 60%	31.3%	8.0%
1983	6 rates	25%, 35%, 45%, 50%, 60% and 65%	33.3%	7.1%
1984	5 rates	35%, 45%, 55%, 60% and 65%	31.6%	6.5%
1985	3 rates	35%, 48% and 60%	31.3%	6.3%
1989	3 rates	32%, 48% and 56%	30.5%	6.4%
1992	2 rates	27% and 48%	34.0%	7.8%
2014	2 rates	20% and 41%	33.9% (2011)	9.1% (2011)

Table 1: Historical Tax rates in Ireland relative to gross income shares

Public Spending on Services, Transfers and Investment (-€500 to -€615 million cost)

The alternative to tax cuts is a stabilisation of Ireland’s tax base, and to “give something back” in the form of support to low income households, by bolstering public services and increasing public investment to support job creation.

There are one million people of working age on weekly welfare payments in Ireland, as well as 535,000 people over 65 receiving the state welfare pensions. Very few of these will benefit from income tax (or PRSI or USC) changes. Yet these changes will reduce the amount of money available to the exchequer and could result in cuts to vital public services or welfare payments on which many of these people rely. In addition, public investment is necessary for sustainable job growth.

The scope of this analysis does not allow TASC to provide a definitive view on what areas of public spending are most in need of additional resources, however five examples of priority areas have been identified.

³¹ Commission on Taxation Report 2009

³² Written response from Finance Minister, June 2013 <http://www.kildarestreet.com/wrans/?id=2013-06-11a.369>

1. Investment

As noted above, investment levels in Ireland remain very low. While the creation of the ISIF (Irish Strategic Investment Fund) may largely cover what level of investment can be plausibly absorbed by existing structures in the economy, capital investment in infrastructure remains a priority.

2. Housing

Measures are required to address housing affordability and to tackle the problems facing social housing and Rent Supplement (and associated schemes). Dublin City Council's recent announcement of a Public Housing approach – combining social and regular rental accommodation – provides a viable solution that is well-tested in other jurisdictions. This model could be adopted in other local authorities.

3. Health

Cost overruns in health are the major spending issue, due to the demand-led nature of health care expenditure. Given the prediction by the new Minister for Health that additional resources will be needed in 2015, it seems prudent to allow some scope for this, noting also the risk of false economies from curtailing prevention and early intervention.

4. Childcare

Childcare costs allied to the economic benefits of pre-school education, and Ireland's very low level of investment in this area compared to other OECD/EU countries, suggests that this would be a cost-effective area for targeting resources. Given that women's participation in the economy is particularly curtailed by the lack of affordable childcare, there is a strong economic argument to ensure that all of Ireland's working age adults who wish to do so, have the opportunity to engage fully in paid employment while raising a family. There is a particular loss if well-qualified graduates are unable to work due to the cost of childcare.

5. Skills Development and Re-Training

While some retraining initiatives have been developed for those who lost jobs in construction, the scale and intensity of these schemes requires significant investment in order to meet the numbers who remain unemployed with inappropriate skills. Such schemes need to be targeted at the highest need cohorts, especially in the regions with highest unemployment.

Section 3: Analysis of the Economic Context to Budget 2015

Features of the Unsustainable Boom

It is impossible and unthinkable for Ireland to repeat the boom. It is impossible, because it is not possible for households and businesses to take on the same level of debt to fuel growth. And it is unthinkable because debt, along with a hollowed out tax base, set the scene for the severity of the Irish economic crash in 2008.

A Hollowed-out Tax System

While household and business debt is widely recognised, the extent to which the hollowing out of the tax base worsened Ireland's national debt catastrophe has not been fully acknowledged at political level. It is well known that Ireland's national debt went from a low of €35.9 billion in 2006 to €173.9 billion in 2013³³. It is less well acknowledged that most of the national debt is due to the hollowing out of the tax base and the consequential gap between tax and spending, rather than the bank bailout (the cost of which was split between increasing the national debt and reducing the National Pension Reserve Fund).

The dominant 'austerity' narrative has been that Ireland was *spending too much* rather than *taxing too little*. The consequence of this narrative was the dominance of cuts to public pay, public services, social transfers and public investment, rather than major tax reform.

While there have been tax changes, including the introduction of USC, the VAT increase and Local Property Tax, these measures addressed the collapse in tax revenue rather than increasing taxation as a percentage of GDP (see Chart 6). What was (and is) needed is to eliminate whole categories of inequitable tax break and to greatly strengthen social insurance in the medium term, while also ensuring those with the greatest income and wealth make a larger contribution.

This skewed analysis of tax versus spending continues to dominate political discourse, with practically all political parties promising one or other form of tax cut, whether through opposition to Local Property Tax and/or water charges, through cuts to income tax or USC, or through new tax reliefs. The local elections were characterised by promises by local council candidates to reduce Local Property Tax by up to 15 per cent (the maximum allowable adjustment), despite the incoherence of the current funding model for local government.

When the unsustainability of these measures becomes apparent, those who are least economically powerful will pay the price (directly and indirectly) through less access to public services and a weaker economy that provides fewer jobs.

Taxation Reality Check

Ireland is a low tax country in a European context. In 2012, total tax take was 30.2% of GDP, which is three-quarters of the EU average of 40.7%³⁴ and much lower than Scandinavian countries (45-50%) or France (47%)³⁵. More importantly, considering the depth of the crisis, tax income as a percentage

³³ <http://www.ntma.ie/business-areas/funding-and-debt-management/debt-profile/historical-information/>

³⁴ Eurostat Database http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en retrieved May 2014

³⁵ When it comes to taxation, GDP not GNP is the correct reference point.

of GDP has not changed (see Chart 6), nor is there any plan for it to change (see Chart 8). The Government’s economic plans are for tax revenue to remain around 32% of GDP until 2018³⁶.

The main explanation for Ireland’s low tax take is the low level of social insurance. The consequences of this are noted below.

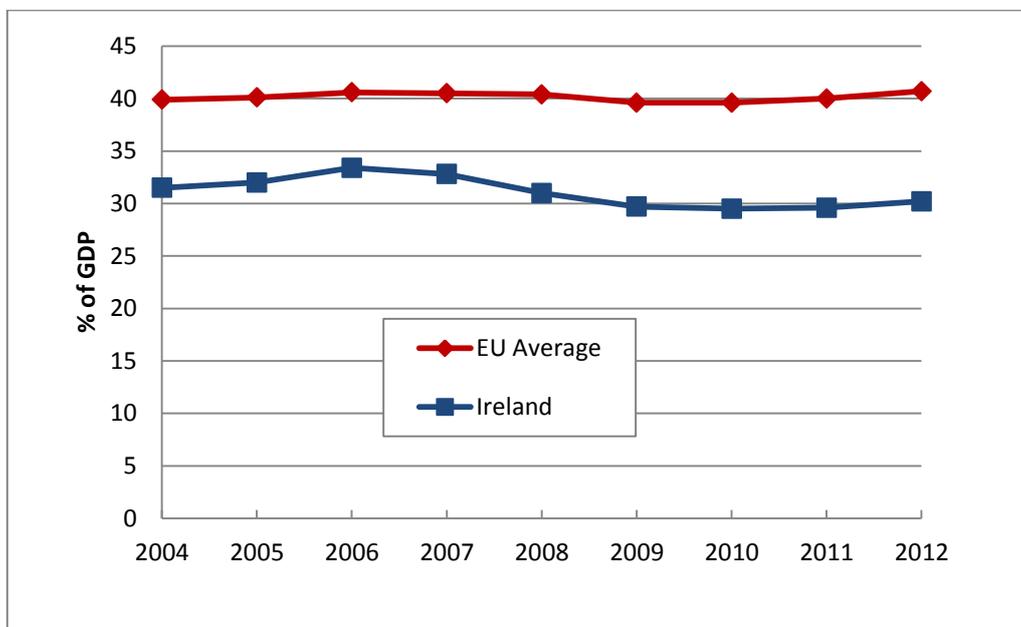


Chart 6: Total tax as a percentage of GDP³⁷

Despite the focus on the marginal rate of tax (41%), the reality is that no one pays even one-third of their income in tax, with the highest average rate of actual tax paid per income group being 30% according to Revenue statistics. This is because of the effects of tax credits, as well as tax reliefs. The average level of tax paid can even be seen to reduce slightly for the highest income levels. The most recent data on actual income tax paid is in Chart 7.

Weak Public Services

The low tax base means that, on the whole, fewer public services are provided in Ireland than in many other European countries. Also, more out-of-pocket costs are required of citizens, which are regressive as they have a biggest impact on those on lower incomes. While social welfare mitigates some costs for some people – e.g. GP fees are covered by Medical Cards and GP cards – many people on lower incomes do not qualify for this assistance, yet find GP fees, prescription charges, ‘voluntary’ school donations, school books, road tolls, public transport fares, television licence fees, etc. to be a significant drain on their resources.

³⁶ DOF (2014) Ireland’s Stability Programme April 2014 Update

³⁷ Eurostat Database http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en retrieved May 2014

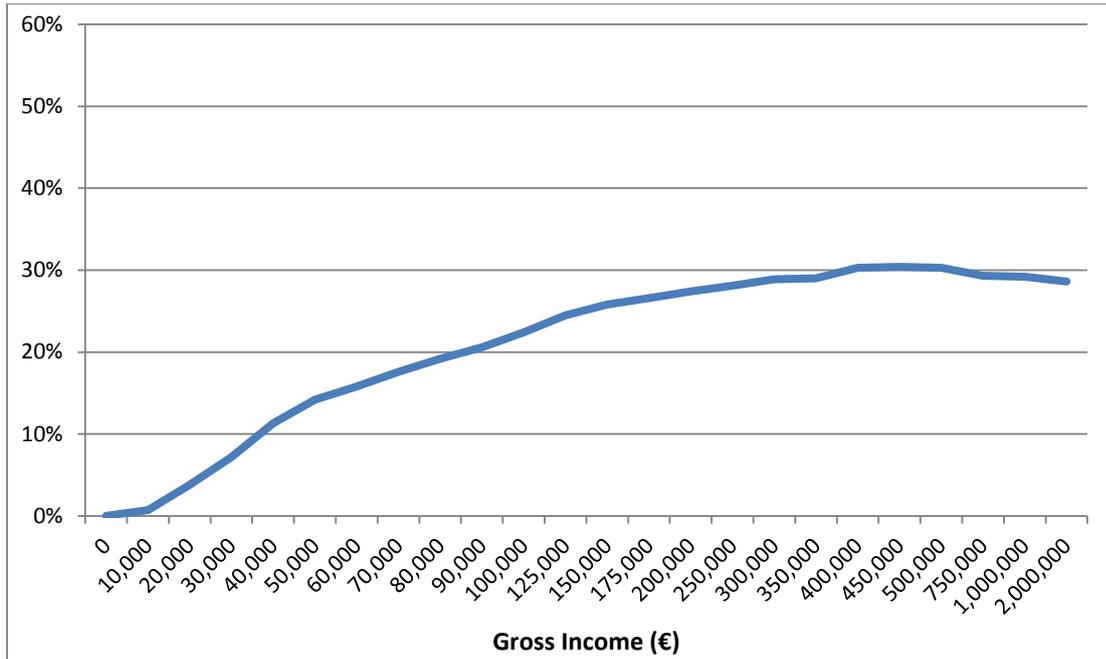
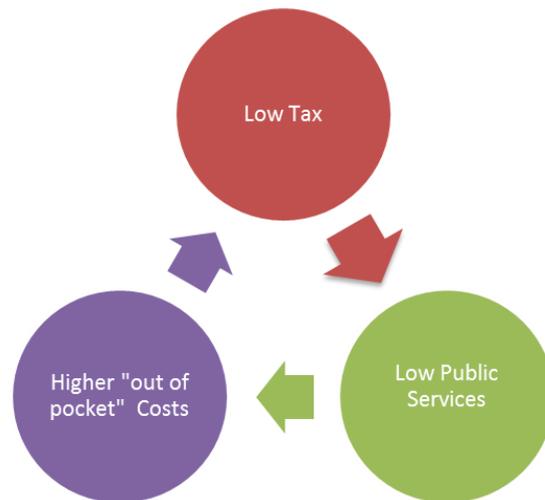


Chart 7: Average Income Tax paid by Gross Income Group (Revenue Data, 2013)³⁸

The result is that we currently have a ‘low tax triangle’. Low taxes lead to higher costs as people pay (in full or part) for services that would otherwise be provided by the state through tax funding. As a result, some people do not see the value of the investment in public services or the full cost of providing quality services. Due to the extent of charges they face, they are also unwilling or unable to pay higher rates of tax without improvements in public services. In this context, in order to preserve and if possible increase public services, Ireland should be planning how to build up the tax base, not continuing to erode it.



Ireland has maintained a low spending/GDP profile throughout the period of growth and collapse in the last decade. Since the onset of the financial crisis, Ireland has seen a reversal from annual increase in public service provision to cuts in services. This is despite population growth, demographic pressure from more young people (for school places) and older people (for pensions and health care).

³⁸ Parliamentary Question Written Response, 51353/13: <http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/takes/dail2013120300055#WRC00350>

The net result of ‘flat lining’ Ireland's overall level of taxation has been to reduce public spending considerably. The plan as outlined in the Government's Economic and Fiscal Outlook (Budget 2014, page D.19³⁹) is to end up with total public expenditure of 37.7% of GDP by 2016.

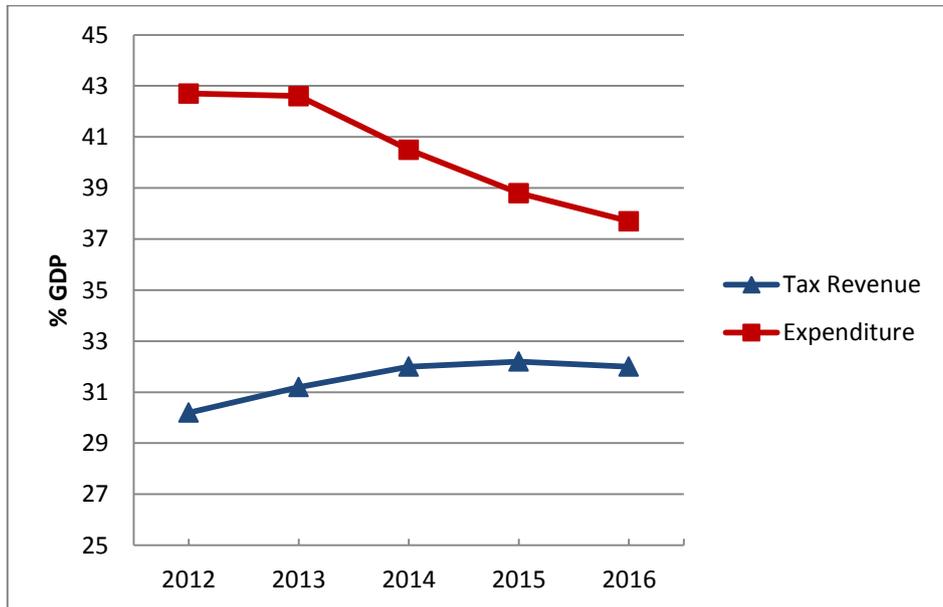


Chart 8: Expenditure v. Taxes and Total Revenue in Ireland 2012 - 2016 (projected)⁴⁰

Given that we have to service a large national debt, including debts associated with bailing out our banking system, this level of tax plans for significantly weaker public services than was provided even before the boom period. That means weaker services and social transfers – and continued low levels of capital investment – all of which negatively affects people on lowest incomes more.

³⁹ Irish Fiscal Advisory Council (2013) Budget 2014 Economic and Fiscal Outlook
<http://budget.gov.ie/Budgets/2014/Documents/Economic%20and%20Fiscal%20Outlook%202014.pdf>

⁴⁰ DOF (2013) Budgetary and Economic Statistics, December 2013
<http://www.finance.gov.ie/sites/default/files/Final%20BES%202013.pdf>

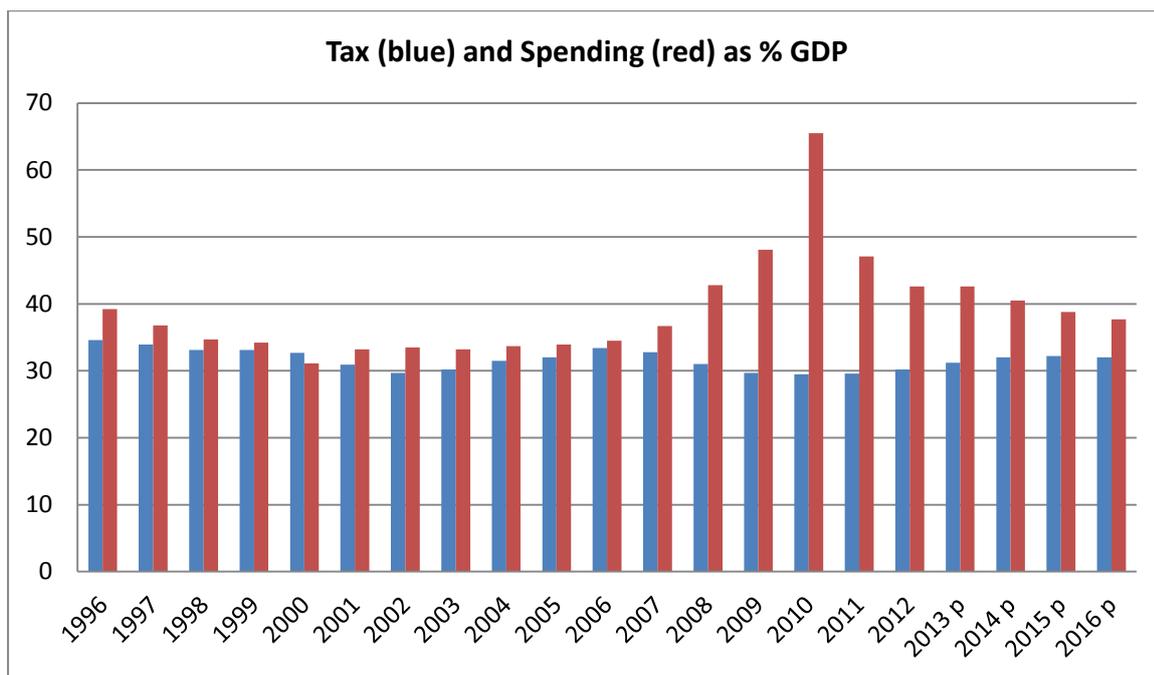


Chart 9: Tax and Expenditure in Ireland as a % of GDP 1996-2012⁴¹ - Note: 2010 expenditure includes the one-off inclusion of the bank promissory note as a cost, even though it will be repaid annually. Figures from 2013-2016 are Department of Finance targets.

The chart illustrates the clear intent of Government policy to maintain the level of taxation – despite demographic pressure and far higher debt-related payments – which means less public funding will be available for services, social transfers and investment. From 2019, the additional debt repayments required by the Fiscal Compact will require either cutting spending in other areas or else raising taxation.

There is also a false economy with excessive cuts. Some public services – such as prevention or early intervention in health, education or social care – have been curtailed, yet they are far more cost-effective than late or remedial action.

The result of the political choice to favour low taxation is that we cannot provide a Western European welfare state. By choosing a level of taxation that is consistently ten percentage points lower than the EU average, Irish governments are choosing low levels of public expenditure that affect the core elements of the social contract between Ireland's State and its citizens.

Weak Social Insurance and Social Transfers

The taxation structure in Ireland is characterised by a reliance on taxes rather than social contributions. Direct and indirect taxation make up 43.4 % and 39.4 % of the total revenue in 2011 respectively, whereas the social contributions raise only 17.2 % of total tax revenue. This share of

⁴¹ Eurostat: http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/dataset?p_product_code=TEC00023

social contributions is the second lowest in the EU. The structure of taxation differs considerably from the typical structure of the EU-27, where each item contributes roughly a third of the total⁴².

Low social insurance has three major economic effects.

Firstly, it must be acknowledged that it significantly reduces labour costs in Ireland relative to other countries. Data from the OECD shows that the so-called ‘tax wedge’⁴³ on a typical family (at 6.8% of labour costs) is the second lowest in the OECD, after Chile and before New Zealand. The tax wedge on a single person is higher (at 26.6% of labour costs), but this is still the seventh lowest in the OECD and the lowest among the OECD’s EU members⁴⁴.

In isolation, lower labour costs might be welcome if it resulted in higher employment and better jobs. Yet Ireland’s overall employment level is relatively low as a percentage of the population (65% against an EU average of 68% and far lower than countries like Germany at 77% and Denmark at 75%⁴⁵). Ireland’s economy has among the largest proportions of ‘low paid’ workers in the EU, with 20.7 per cent of workers classified by the EU as ‘low paid’ (earning less than €12.20 per hour)⁴⁶

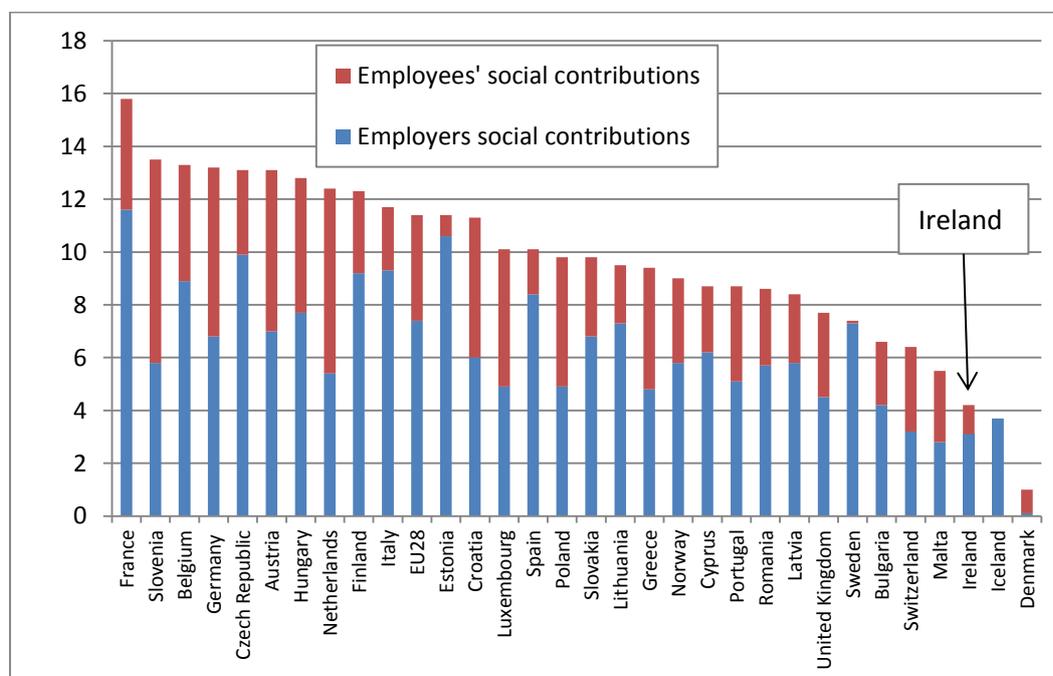


Chart 10: Social Insurance Contributions of employees and employers (as a % of GDP)

⁴² Eurostat (2013) *Taxation Trends in the European Union* http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-DU-13-001/EN/KS-DU-13-001-EN.PDF

⁴³ The ‘tax wedge’ is defined as the difference between the salary costs of a single “average worker” to their employer and the amount of net income (“take-home-pay”) that the worker receives. The taxes included are personal income taxes, compulsory social security contributions paid by employees and employers, as well as payroll taxes. The amount of these taxes is expressed as a percentage of the total labour costs for firms.

⁴⁴ OECD (2014) *Taxing Wages 2014* <http://www.oecd.org/tax/tax-policy/taxing-wages.htm> Data from Table 0.4

⁴⁵ Eurostat: http://epp.eurostat.ec.europa.eu/portal/page/portal/employment_unemployment_ifs/data/main_tables

⁴⁶ NERI (2013) *Quarterly Economic Observer December 2013* http://www.neriinstitute.net/download/pdf/neri_qeo_december_2013.pdf

Secondly, a negative effect of low social insurance is that people’s entitlement to income replacement due to injury, illness or unemployment is set at a standard, subsistence level, whereas other European social insurance systems replace a large proportion of lost earnings – with people receiving an income from the social fund that is proportional to what they paid in. This increases the power of the ‘automatic stabiliser’ effect of welfare in other economies, as higher social insurance incomes keeps consumer demand up in the economy. It also provides people with more time to maintain their outgoings (e.g. mortgage repayments), to recover (if ill/injured) and/or to secure another job (if unemployed).

This illustrates the third effect, which is that weak social insurance means people on lower incomes in Ireland face a disproportionately large burden of risk and financial insecurity. Social insurance shares risks across society, which protects people who are unlucky enough to become injured, ill or unemployed. The high risk burden means that even households with formerly good incomes and savings can be overwhelmed by health costs and mortgage repayments in the case of job loss or long-term illness.

Weak Public Investment

At 10.7 per cent, Ireland has the lowest level of fixed capital formation (public and private) in the European Union (see Chart 11). Low capital expenditure undermines Ireland’s medium term growth potential and runs counter to the goal of long-term debt sustainability.

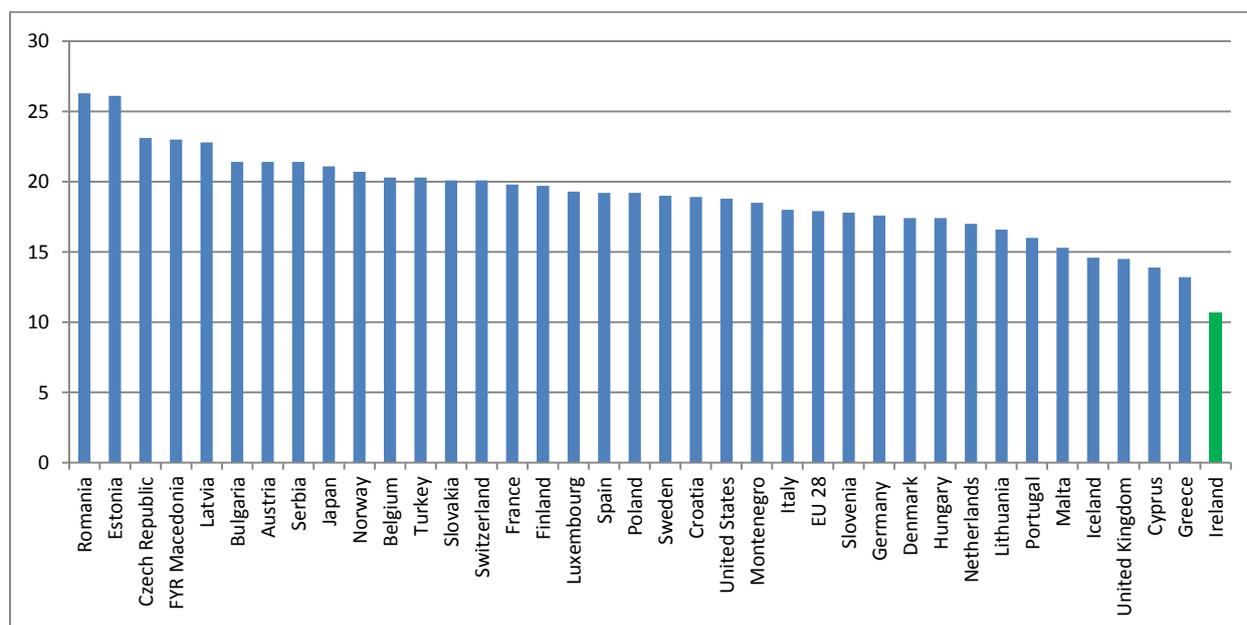


Chart 11: Fixed Capital Formation (Public and Private) % of GDP⁴⁷

Another false economy arises in relation to maintaining Ireland’s infrastructure. The disinvestment in physical infrastructure, such as roads, means that minor repairs may grow to become major cost items. Rebuilding roads, rail, bridges, waterworks or cabling is far more costly than keeping such infrastructure in good repair.

⁴⁷ Eurostat: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/National_accounts_and_GDP

Debt Interest and Debt Payment

In 2012, debt interest was €5.9 billion (8.5% of total spending). This was a similar amount to total spending on out-patient services in the health sector of €5.4 billion (7.8%)⁴⁸. It is also not far behind the largest spending items, such total spending on old age pensions (€7.6 billion or 10%) or education (€8.5 billion or 12%).

By 2016, the Department of Finance figures project that debt payments will be €9.2 billion, which will be 14% of government expenditure and 21% of all tax revenue⁴⁹. Despite the hoped for reduction in interest costs from early repayment of the IMF debt (and taking on cheaper debt from the markets), which may reduce this projection, Ireland's overall debt interest bill is still eye-wateringly high.

Moreover, under the European Fiscal Compact, which 60.3 per cent of Irish voters approved in a referendum in July 2012, Ireland is committed to reducing the national debt. The amount to be reduced annually is calculated as one twentieth of that part of the debt over 60 per cent of GDP. Based on a General Government Debt of €215 billion (end-2013)⁵⁰ and GDP in 2013 of €169 billion, the surplus debt is €113.6 billion and Ireland is required to pay down one twentieth of that, which is approximately €5.7 billion, in addition to annual debt interest payments. This requirement begins from 2019⁵¹, but it is such a huge requirement that several years of preparation will be required so that Ireland is running a surplus of tax over spending sufficient to cover this level of repayment without breaching the 3 per cent deficit limit.

There are five Budgets left to achieve this, and while economic growth will play an indispensable part in achieving this commitment, there is a risk that auction politics to do with tax cuts at Election 2016 will undermine Ireland's capacity to do so without a further, unwelcome series of austerity budgets after the next general election. If the Government is to achieve its goal of breaking the boom-bust cycle, all five Budgets need to be used to prepare the public finances for the shock that the Fiscal Compact requirements represent.

Economic Inequality

Since the 1980s Ireland has experienced, in line with most other western economies, a persistent rise in economic inequality. The initial aftermath of the economic crisis of 2008 led to a brief reduction in some statistical measures of income inequality (due to rising unemployment, a falling number of people on incomes above €100,000, and the preservation of some core welfare rates). However, since then, these trends have been reversed as incomes over €100,000 have risen and minimum wages and welfare rates have stayed constant or fallen in both real and nominal terms. The Gini Co-efficient, the most widely used (though not necessarily the most comprehensive) measure of income inequality was higher in 2012 than it was in 2008⁵². This means that in this period taking taxes and welfare payments into account, overall income inequality rose. There has therefore been no clear reversal of the trend towards rising income inequality in Ireland (illustrated in the chart below).

⁴⁸ Eurostat: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/database

⁴⁹ DoF (2013) Economic and Fiscal Outlook:

<http://budget.gov.ie/Budgets/2014/Documents/Economic%20and%20Fiscal%20Outlook%202014.pdf>

⁵⁰ <http://www.ntma.ie/business-areas/funding-and-debt-management/debt-profile/>

⁵¹ http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm

⁵² <http://www.cso.ie/en/statistics/socialconditions/surveyofincomeandlivingconditionssilcmainresults/>

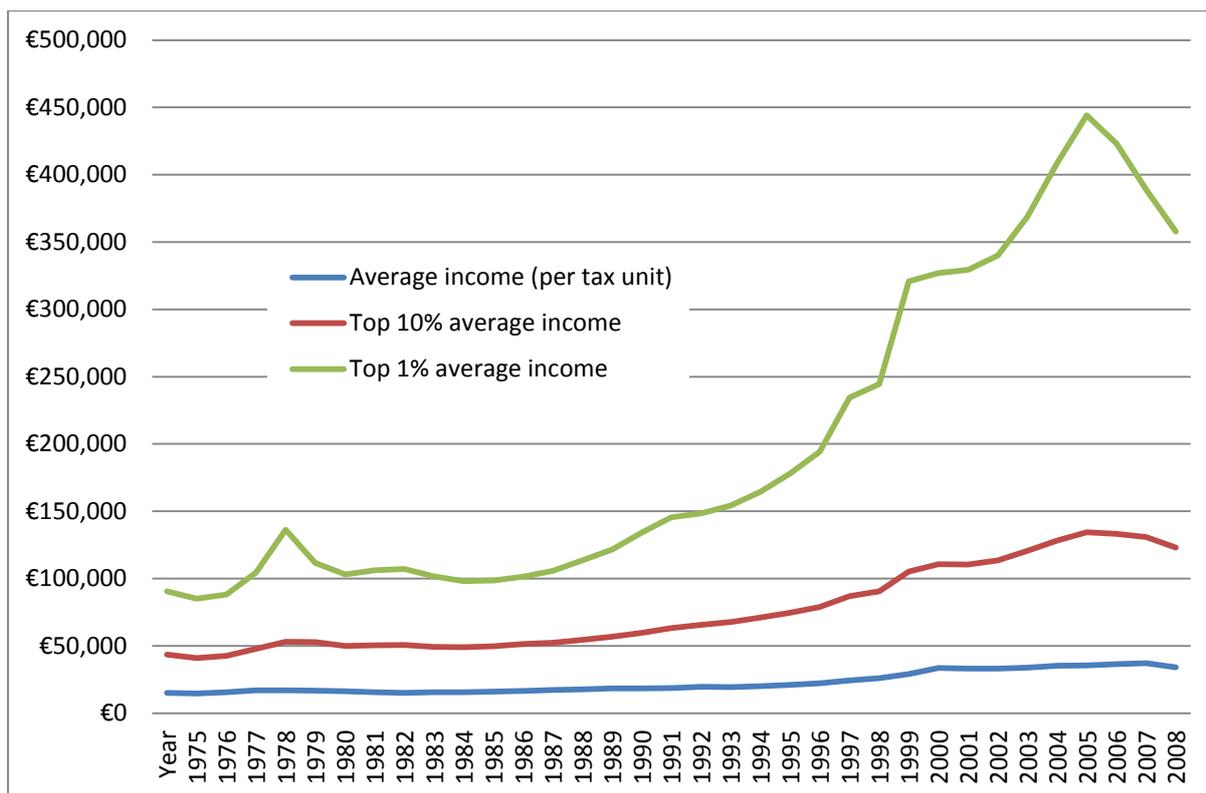


Chart 12: The rise of Top 1% and Top 10% Incomes in Ireland is greater than average income growth (income figures are adjusted for 2010)⁵³

Distribution effect of previous budgets

Previous budgets have been regressive in that they have hit those on low incomes harder than those on higher incomes. The ESRI have estimated the combined impact of budgets from 2009 to 2014, contrary to some perceptions of a sharper squeeze on middle income groups, the greatest losses have been at the top and bottom of the income distribution⁵⁴.

The most recent Budget 2014 had its greatest impact – a reduction of 2 per cent – on low income groups. The lowest impact was on some middle income groups (a loss of 1 to 1¼ per cent) while the top income group lost slightly less than 1¼ per cent – somewhat more than the middle, and less than the bottom income group⁵⁵.

A Better Model for Ireland based on Shared Prosperity

Stable Growth

Ireland’s growth is contingent on external factors such as export markets, the behaviour of multi-national corporations (MNCs) based in Ireland and other global influences. In particular Ireland will be impacted by the EU and USA’s moves to curtail aggressive tax avoidance by multi-nationals, including those headquartered in Ireland. In this context, it is important to recognise that Ireland’s Gross National Product (GNP) growth has lagged behind Gross Domestic Product (GDP) growth and

⁵³ World Top Incomes Database <http://topincomes.g-mond.parisschoolofeconomics.eu/> accessed May 2014

⁵⁴ https://www.esri.ie/UserFiles/publications/QEC2013Win_SA_Callan.pdf

⁵⁵ https://www.esri.ie/UserFiles/publications/QEC2013Win_SA_Callan.pdf

has still not recovered. This will impact on jobs growth because MNC activity in Ireland is far less job-intensive than domestic business growth, particularly in Small and Medium Sized Enterprises (SMEs).

Wage-Led Recovery

Ireland has an opportunity to learn from the mistakes of the boom period and to be a leader in forging a reformed economic model that relies less on the financial sector and more on aggregate demand in the domestic economy for goods and services.

The Government's proposed Low Pay Commission is likely to find that many workers in Ireland do not receive a 'living wage' that permits them to attain even a modest decent lifestyle. The affordability crises in housing, childcare, health insurance and energy costs have not been ameliorated by laissez faire policies. On the contrary, lack of regulation has exacerbated the problem.

Researchers have demonstrated the viability of a wage-led growth model for Europe⁵⁶. Even the ECB's President, Mario Draghi, has acknowledged lack of demand as a major problem for Europe. Wage increases would increase aggregate demand, especially purchasing of goods and services from Irish SMEs across the country. This would also increase tax revenue and lower the cost of welfare schemes that subsidise the incomes of working families.

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⁵⁶ See, for example, http://www.feps-europe.eu/en/news/475_a-wage-led-growth-strategy-for-europe-an-alternative-to-the-crisis-of-debt-led-and-export-led-growth or http://www.ilo.org/global/publications/books/forthcoming-publications/WCMS_218886/lang-en/index.htm