Clear Stark Choices

Budget 2016

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You are the Minister for Finance

- You consider the following issues:

- ✓ Growth rates will de-accelerate by half over the next few years: GDP growth will fall from 6.2% this year to 3.2% by 2018 and tail off further at the end of the decade.
- ✓ The tailwinds – low oil prices, low interest rates, favourable exchange rates – unlikely to be maintained to the end of the decade
- ✓ Uncertainty over our corporate tax regime with international negotiations, e.g. OECD BEPS and EU CCCTB
- ✓ A potential corporate tax revenue bubble emerging – with revenue expected to grow by over 40% within two years
- ✓ Uncertainty over unwinding monetary policies: IMF warns of global recession if interest rates are increased BUT central banks warn of financial instability caused by increasing asset bubbles if low rates persist
- ✓ The Department of Finance calls these '*considerable uncertainties*'

- Is this the best time to cut your revenue stream?

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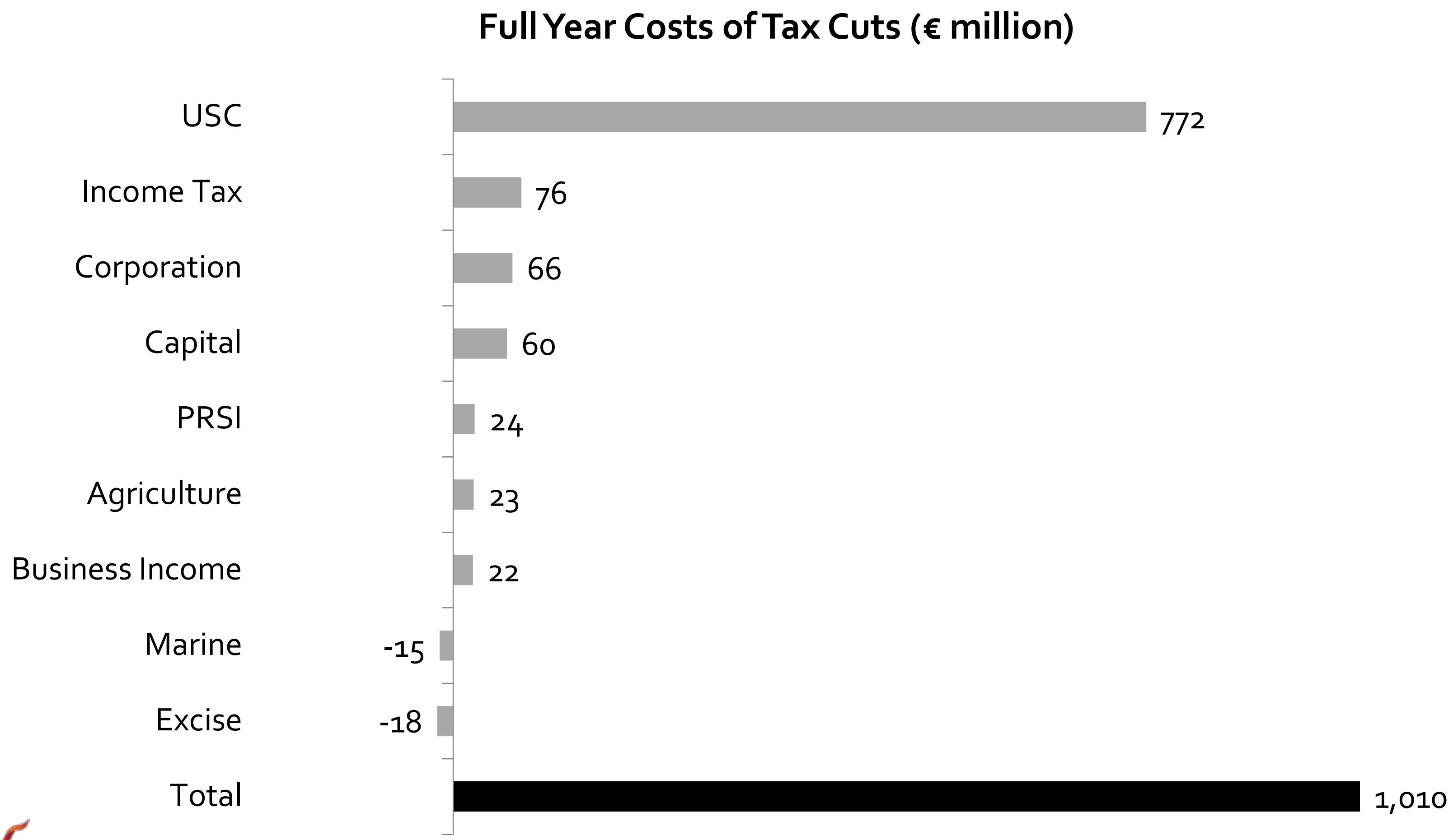
The Tax Cuts


Full Year Costs of Tax Cuts (€ million)
USC
772
Income Tax
76
Corporation
66
Capital
60
PRSI
24
Agriculture
23
Business Income
22
Marine
-15
Excise
-18
Total
1,010

USC and CAT: Benefits of a Loud Lobby

- The cuts in USC represented 76% of net tax cuts.
- USC is the ultimate anti-avoidance tax: simple and transparent with limited reliefs.
- Finance Minister and Taoiseach have promised to abolish USC in the next Dail.
- The biggest beneficiaries: high income groups / tax avoidance industry.

- There was a campaign to cut inheritances taxes on the basis of increased Dublin property prices.
- Economists agree that taxing passive income is preferable to taxing labour.
- Between 1965 and 1974, revenue from inheritance tax averaged 4.7% of GDP. 2016 estimate: 1.7% (the difference is €600 million)
- Budget cut in inheritance tax (increased thresholds) cost €33 million.
- An inheritance of €500,000 to benefit by €18,000.

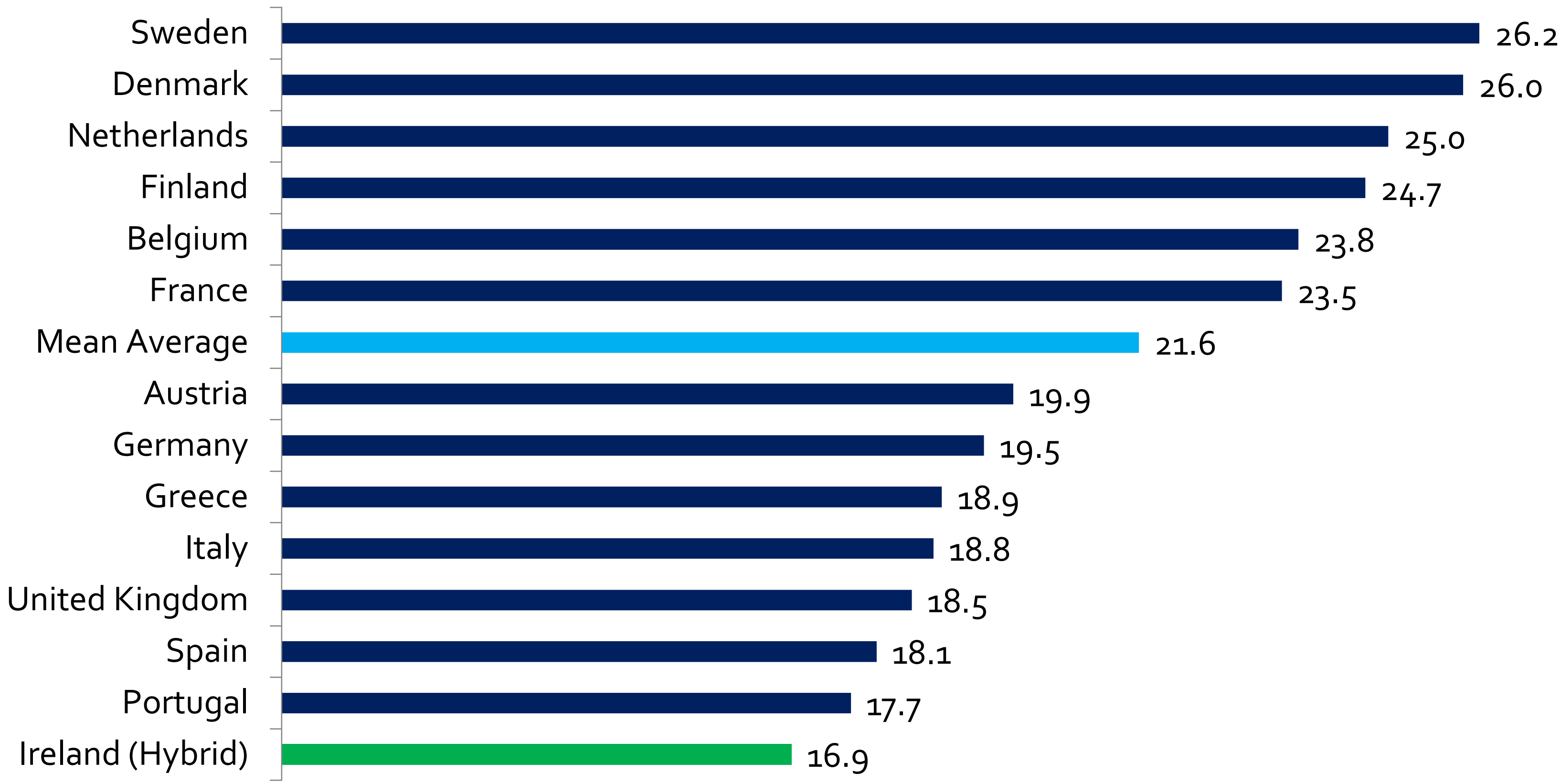
Most are Extremely Low Taxed

OECD: Average Tax Rates Single Person (%)

Low Pay - €18,000		Average Pay - € 36,000		High Pay - €85,000	
Denmark	36.2	Denmark	38.1	Denmark	47.8
Germany	26.9	Germany	33.1	Netherlands	40.9
Belgium	23.6	Belgium	32.6	Belgium	40.8
Austria	20.1	Greece	29.3	Germany	39.9
France	18.6	Netherlands	28.5	**Ireland**	**35.6**
Average	**18.0**	Austria	27.6	Finland	35.2
Netherlands	18.0	**Average**	**25.5**	**Average**	**34.8**
Finland	16.9	Finland	24.8	Austria	34.4
UK	15.7	Italy	23.9	Italy	32.4
Sweden	15.5	Portugal	22.3	Portugal	32.2
Italy	13.9	UK	21.4	Sweden	32.2
Portugal	13.8	France	20.8	Greece	31.5
Greece	12.7	Sweden	18.6	UK	30.2
Spain	11.7	**Ireland**	**18.5**	Spain	27.7
Ireland	**9.0**	Spain	17.7	France	25.8

But Public Services are Under-Resourced

Expenditure on Public Services: 2016 (% of GDP)



To reach mean average of other EU states: Irish public services spend would need to increase by €9 billion.

Back to First Principles of Economic Growth

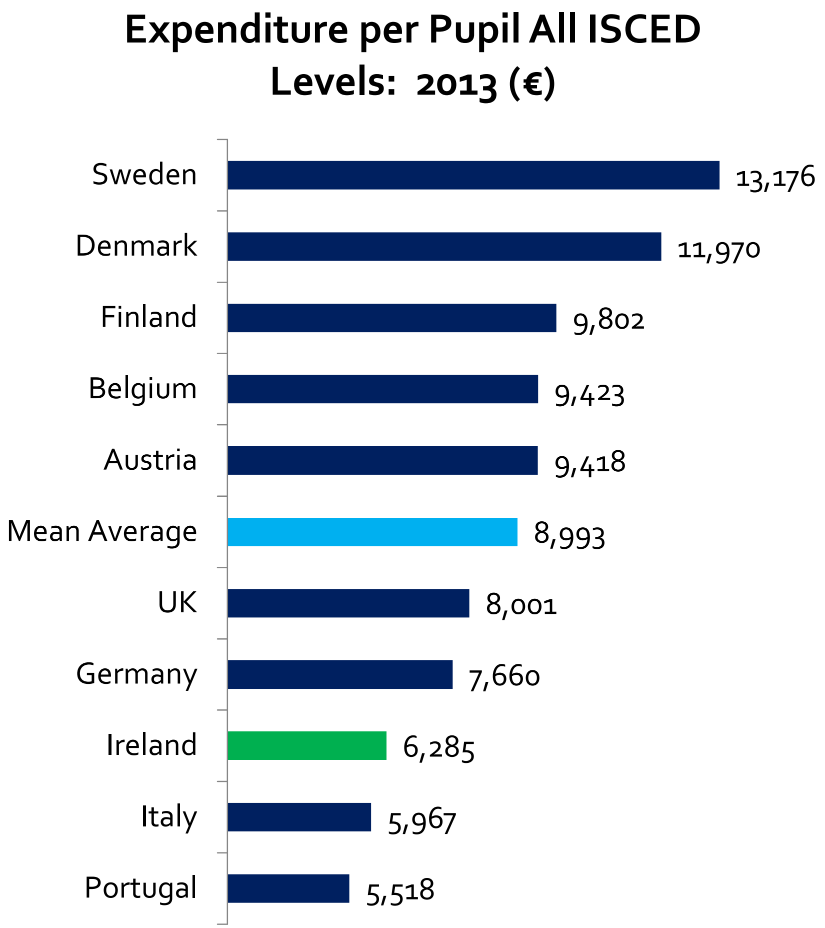
- As Minister for Finance you are sceptical of cutting taxes given the Department of Finance's '*considerable uncertainties*'
- You are sceptical that cutting taxes for people who are already low-taxed will reap benefits in living standards while public services are starved
- What do you?
- You return to the first principles of economic growth
- You return to evidence-based policy

1st Principle: Investment

- Investment is the single biggest driver of economic growth. In the last 25 years, investment was responsible for over 50% of Irish growth (similar to other advanced economies). Low investment = long-term low growth.
- Irish public investment ranks 26th out of 28 EU countries –approx. 2% of GDP.
- Under the Government's Capital Programme, public investment will remain at 2% of GDP by 2021.
- To reach Ireland's 35-year average, investment would have to increase from €27 billion to €40 billion over the next 6 years – advanced broadband, water & waste, social housing, green technologies, public transport
- AND: this doesn't count the fact that private sector investment (excl. R&D) is nearly 20 % below EU average.

2nd Principle: Education

- Education and skills (labour quantity and quality) is the next biggest driver of economic growth.
- Irish expenditure per pupil is low compared to other EU-15 countries. Ireland would have to increase spending by 40% to reach average of reporting countries (more if PPS were used).

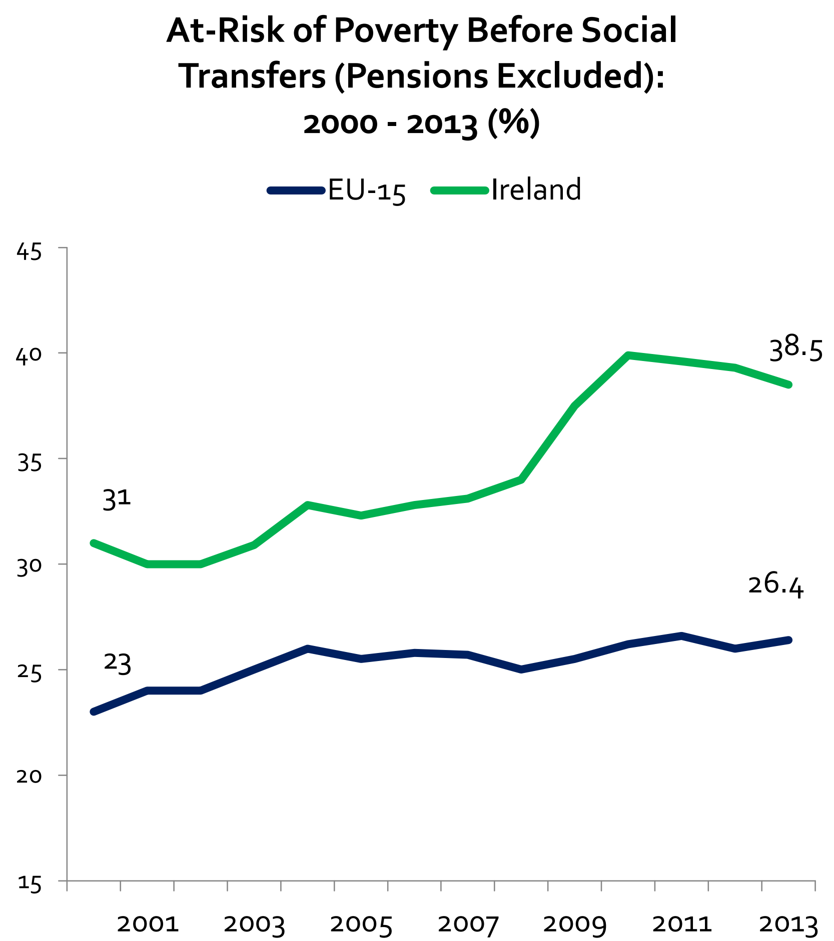


3rd Principle: Equality

- While not a growth accounting category, there is increased interest in the relationship between inequality and growth.
- The IMF estimates that, in terms of income shares, the most positive growth benefit comes from increasing the income share of the lowest 20% income group while increasing the income share of the highest income group results in negative growth.
- Reducing inequality is not just about cash transfers – it also relates to access to public services (health, education). Nor is it about the tax/social transfer process.

Market Inequality

- Ireland has a high level of market inequality. To address this:
- Raise statutory wage floors (e.g. minimum wage, JLCs, Living Wage)
- Increase labour rights (collective bargaining, part-time workers' rights)
- Increase social wage – to provide pay-related social protection benefits and access to public services for free or at below-market rates (e.g. health).
- Rebalance indigenous sector (17% employed by market indigenous firms are in the hospitality sector – 9% average in the EU).



Other Key Issues

- **Childcare**: to increase labour supply
- **Poverty Reduction** – poverty impairs human capital; in particular, child poverty
- **Social Housing** – new cost-rental models to deliver off-balance sheet investment (e.g. public housing associations); rebalance economy from rentier to productive sectors and facilitate labour supply
- But increasing public expenditure not always the full answer

2013 Health Expenditure (% of GDP)

- Irish health expenditure is 7% above mean EU-15 average.
- Spending on Hospital Services 44% <u>below</u> EU average
- Spending on outpatients services is 59% <u>above</u> EU average
- Spending on medicines and medical equipment is 32% <u>above</u> EU average
- Administrative costs are double that of the EU average
- Outpatients and medicines / equipment is where the system interfaces with private agents and for-profit incentives. Is this driving costs?

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Clear Stark Choices

- The Government's baseline envisages eliminating the structural deficit) by 2018. However, we are not required to do so until 2020. By maximising the fiscal space the next government would have an additional €6 billion extra to spend over the next four years.
- However, this will not be sufficient to drive the necessary social and economic investment.
- This means not only abandoning the tax-cutting agenda; it means increasing revenue. This is the future dividing line:
- Cut or raise taxation
- Shrink or expand investment and the social state
- Undermine or promote long-term sustainable growth.
- If you are the Minister for Finance the choice is clear, the choice is stark.