Quarterly Economic Observer

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NERI Nevin Economic Research Institute

About NERI and this publication

The Nevin Economic Research Institute (NERI) has been established to provide information, analysis and economic policy alternatives. Named in honour of Dónal Nevin, scholar, trade unionist and socialist who gave a life of service to the common good, the Institute aims to undertake research that will be of relevance to the Trade Union movement and the general public across the island of Ireland.

This is the seventh Quarterly Economic Observer (QEO) of the Institute. The purpose of the QEO is to provide regular, accessible and timely commentary so as to equip trade unions and others in articulating and advancing a new economic paradigm where the old has failed. The QEO complements the NERI Autumn 2013 Quarterly Economic Facts (QEF) which provides a set of statistical indicators to underpin our analysis. Unless otherwise stated, the data cited in this Observer are the latest available as of early-September 2013. The final draft of this document was completed on 16th September 2013.

This report has been prepared by staff of the Institute. We are grateful to two external reviewers from the academic and research community who reviewed and commented on an earlier draft of this document. The analyses and views expressed in this publication are those of the NERI and do not necessarily reflect those of others including the Irish Congress of Trade Unions or the unions supporting the work of the Institute.

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www.NERInstitute.net

The Nevin Economic Research Institute

Quarterly Economic Observer

Autumn 2013

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Executive Summary

This edition of the NERI's *Quarterly Economic Observer* (QEO) outlines our latest expectations for the economic outlook in the Republic of Ireland and Northern Ireland (Section 3) and develops the NERI's proposals for the forthcoming Budget 2014 fiscal adjustment planned in the Republic (Section 4). In particular, we focus on the potential to raise additional taxation revenue from income taxes focused at those in the top 10% of the income distribution.

Economic Outlook

The economic outlook for both parts of the island of Ireland remains uncertain. In the Republic, there are mixed signals pointing towards stability, even tentative recovery, alongside concerns on export growth, domestic demand, continuing long-term unemployment and declining GDP. In the North, there are some positive economic signals, reflecting recent developments in the UK economy as a whole, although these positive trends are recent and at this stage any recovery is at best fragile. In both economies challenges remain given high, if declining, unemployment and weak levels of household spending and investment.

Based on the assumptions and expectations outlined Section 3, our current projections for the Republic of Ireland include:

- Depressed but positive GDP growth of 1% in 2013, increasing marginally to 1.2% in 2014, 1.8% in 2015 and reaching 3% in 2016.

- Modest employment growth of 1.4% in 2013, rising to 1.7% in 2014 and 2.2% in 2015.

- A steady decreased in unemployment out to 2016, with a 2013 figure of 13.8%. By 2016 we expect unemployment to reach 12.1%. High structural unemployment remains a core policy challenge.

- The national debt peaking as a % of GDP in 2013 (123.6% approximately €207 billion).

- The improvements in the labour market impact positively on exchequer finances with the General Government Deficit falling to 4.6% in 2014, reaching 3.1% in 2015 and 2.4% in 2016.

Budget 2014, Income Taxes and High Earners

We reiterate our recommendations for the scale and composition of the fiscal adjustment planned for Budget 2014, first outlined in our *Summer 2013 QEO*:

- The Budget 2014 fiscal adjustment should be €2 billion rather than €3.1 billion with the saving on the Promissory Note restructuring used to reduce the Budget's scale.

- The remaining adjustment should be re-orientated towards taxation measures with the only expenditure cuts being those already agreed and announced under the two public sector wage agreements.

- The Budget should be accompanied by an Investment Stimulus which would assist in counteracting the negative impact of the Budgetary adjustment on the domestic economy.

In this edition we focus on potential to raise additional income taxation revenue from the top of the income distribution. Section 4 outlines that:

- Budget 2014 could raise an additional €400 million from households in the top 10% of the income distribution (above €109,000 gross income per annum).

- Currently the top 10% of households have an average effective tax rate of between 22.5% and 27.5% (overall average 25.6%).

- A 1.5% increase in this rate would raise €400m in a full year, equivalent to an average of €46 in additional income taxes per household per week.

- The spread of income within the top decile suggests that these increases should be designed to be progressive; those within that decile with higher income should experience a greater increase than those with a lower income.

1 Introduction

The economic outlook for both parts of the island of Ireland remains uncertain. In the Republic, there are mixed signals pointing towards stability, even tentative recovery, alongside concerns on export growth, domestic demand, continuing long-term unemployment and declining GDP. In the North, there are some positive economic signals, reflecting recent developments in the UK economy as a whole, although these positive trends are recent and at this stage any recovery is at best fragile. In both economies challenges remain given high, if declining, unemployment and weak levels of household spending and investment.

In this *Quarterly Economic Observer* (QEO) we revisit our proposals for the Budget 2014 fiscal adjustment planned in the Republic. In the Summer 2013 edition we outlined our recommendations for the composition and scale of that adjustment allied to a timely and effective investment stimulus. We develop this further here (Section 4), focusing on the potential to raise additional taxation revenue from income taxes focused at those in the top 10% of the income distribution (above a household gross income of €109,000 per annum).

The QEO is structured as follows. Recent economic trends in both parts of Ireland are reviewed in Section 2. Section 3 provides an overview of recent macro-economic projections made by various agencies and includes the NERI's macroeconomic projections out to 2016. In Section 4 we address the choices Government in the Republic is currently considering regarding Budget 2014 and outline our recommendations for that fiscal adjustment. In particular, that section focuses on the potential to raise additional revenue in income taxes from high earners. Section 5 concludes.[1]

The Nevin Economic Research Institute (NERI) offers this report as a contribution to public debate on policy making and formation on the island of Ireland. We welcome feedback, comment and suggestions. The precise data used and the specifics of any proposal/projections are subject to review as fresh information and data become available.

[1] The analysis here complements a number of recent research papers and the Summer 2013 NERI QEO. These are all available on the NERI website.

2 Overview of Recent Economic Trends

This section of the Quarterly Economic Observer (QEO) examines the most recent trends in a number of key economic indicators in both the Republic of Ireland and Northern Ireland. Across both, the data points towards uncertainties in the direction of economic activity with initial signs of economic recovery coinciding with negative developments elsewhere. Recent economic developments are summarised in table 2.1.

Table 2.1 Some key economic trends in Ireland and the UK (2007-2012)

		2007	2008	2009	2010	2011	2012
Total Employment ***(% of the working-age population)***	ROI	69.2	67.6	61.9	59.6	58.9	58.8
	NI	68.4	67.8	64.7	66.0	67.4	67.3
	UK	71.5	71.5	69.9	69.5	69.5	70.1
Unemployment ***(% of labour force)***	ROI	4.7	6.4	12.0	13.9	14.7	14.7
	NI	4.0	4.5	6.5	7.1	7.2	7.5
	UK	5.3	5.6	7.6	7.8	8.0	7.9
Gross Domestic Product (% volume change over previous yr)	ROI**	5.4	-2.1	-5.5	-0. 8	2.2	0.2
	NI*	3.1	-2.1	-4.4	1.1	0.1	n/a
	UK	3.4	-0.8	-5.2	1.7	1.1	0.2

Sources: Republic of Ireland (ROI) and UK labour market data refer to the whole year and were taken from the Eurostat Labour Force Survey database (online reference code lfsi_emp_a and une_rt_a).
Northern Ireland labour market data are based on an average of the four quarters for each year with data taken from the Labour Force Survey.
GDP data for ROI and UK are from Eurostat National Accounts database (reference code nama_gdp_k).
Northern Ireland Gross Value Added data are taken from ONS Regional Trends Series (Office for National Statistics, 2013).

Notes: ROI = Republic of Ireland, NI = Northern Ireland and UK = United Kingdom.
* Northern Ireland output refers to Gross Value Added (GVA). Regional GVA (Income Approach) is taken from Office for National Statistics (2012) December.
Total employment refers to all persons in employment (ILO definition) aged 15-64 as a proportion of all persons aged 15-64. Unemployment is measured on the ILO definition basis and refers to persons aged 15-74.
** ROI data for 2011 and 2012 from CSO. Other years from Eurostat.
n/a = not available.

The remainder of this section is structured as follows. Initially, to set a context for our review, we overview developments in the global, European and UK economies.

Subsequently we examine recent trends in the Republic and the section concludes by examining Northern Ireland.

2.1 Global Developments (including UK)

Uncertainty and fragile growth are the main themes for the present circumstances of the international economy. In the US growth remains positive, but the most recent OECD (2013a) expectations are for a GDP increase of 1.7% in 2013, more than 1% below that of for 2012 (2.8%). The most recent quarterly data for the Eurozone is positive (+0.3% in Q2 2013) ending six successive periods of contraction. Within that area, a number of countries remain in recession including Spain, Italy, Cyprus, Netherlands and Slovenia and while the outlook is for a stabilisation of economic activity at low levels, the ECB note that the risks surrounding the economic outlook continue to be on the downside (Eurostat, 2013:3 and ECB, 2013:5). Growth in the wider EU-28 is marginally higher, at 0.4% in Q2 2013, but remains weak.

The combined effects of weak domestic economic activity, simultaneous fiscal consolidation, slowing growth in emerging economies and speculation regarding the gradual removal of central bank market supports are the context for the ongoing international economic uncertainty. An acceleration of any of these factors could weaken the economic outlook and dampen the fragile growth reported above.

The UK economy has returned to positive GDP growth in 2013, moving from -0.2% in Q4 2012 to +0.3% and +0.7%, respectively, in Q1 and Q2 of 2013 (ONS, 2013). However, while growth is broad based, across all the main sectors of the economy, its scale reflects its fragility. Reflecting this, data for the UK wide labour market shows flat employment and unemployment rates, at approximately 71.6% of those aged 16-64 years and 7.7% of the economically active population respectively.

2.2 Republic of Ireland

Much like the international economy, the outlook for the Republic of Ireland's macroeconomy remains challenging and uncertain. Since our last QEO, there have been a series of mixed signals suggesting both emerging recovery and uncertain prospects. On the positive side, these include:

- A 1.8% increase in total employment in the year to Q2 2013 comprising 21,600 additional full-time jobs and 12,100 part-time jobs. 85% of this increase was for males with most of the jobs (almost 80%) emerging in *Agriculture, forestry and fishing* (+18.7% or 16,300) and *Accommodation and food service activities* (+8.0% or 9,600).[2]
- A further decrease in the rate of unemployment to 13.7% (300,700 individuals).[3]
- An increase in the labour force to 2.17 million people; the first increase since Q3 2008.
- A 4.6% reduction in underemployment compared to Q2 2012 bringing the numbers underemployed (working but with less hours that they wish to have) to 149,400 people.
- An annualised increase of 2.9% in real Gross National Product (GNP) between Q1 2012 and Q1 2013.[4]
- A 6% increase in the number of trips to Ireland in period January-July 2013 compared to a year earlier plus some evidence of an increase in domestic holidaying.[5]
- A small increase of 1.3% in the volume of retail sales (excluding motor trades) in the year to June 2013.
- A further reduction in the cost of borrowing as indicated by a yield of 3.84% on a Government 10-year bond in July 2013 compared to approximately 7% a year earlier.
- The formal establishment of the Ireland Strategic Investment Fund (ISIF) with €6.3bn allocated from the NTMA discretionary portfolio to fund commercial domestic investment opportunities.
- Positive signals that Ireland will be able to fully re-enter the capital markets in 2014 following the end of the current Troika lending programme.

On the negative side, these include:

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[2] The CSO QNHS report (August 2013) suggests particular caution in the interpretation of data and trends in the Agricultural, forestry and fishing sector due to statistical revisions to the sample following Census 2011. (2013c)
[3] Based on ILO definitions of labour force status.
[4] FitzGerald (2013) notes that a large proportion of this increase is likely to be explained by an increase in the number of re-domiciled companies in the Republic.
[5] A trend which may have been impacted by 'the Gathering' 2013.

- Sustained high levels of net outward migration with an estimated 33,100 more people emigrating than immigrating in the year ending April 2013.
- Decreases in employment among those aged 25-34 (-11,900 or -2.3%) and 20-24 (-2,100 or -1.7%) in the year to Q2 2013.
- Increases in female unemployment by 4,600 (+4.3%) to 111,200.
- Sustained high levels of youth unemployment (rate for 15-24 year olds at 29.6%) and long-term unemployment, with the latter accounting for 58% of the total unemployed.
- A decline in GDP in Q1 2013 of -0.6% driven by decreases in exports and investment.
- A decline in domestic demand of -1.6% in Q1 2013 following a decline of -0.6% in 2012.
- Weaker than expected exchequer VAT returns in the year to date, suggesting declines in consumption and activity in the domestic economy.
- Investment levels in the economy continue to sit at record low levels of close to 10% of GDP.
- Continuing mortgage loan distress with the proportion of Private Dwelling House loans in arrears of more than 90 days rising to 12.7% (97,874 loans) at the end of June[6].
- A growing probability that Ireland's banks will require additional capital injections, some of it sourced from the exchequer, to address the mortgage distress crisis and the forthcoming Basel III capital reporting requirements.

Overall, as we outline in the next section, there are signs of progress but remaining challenges and threats to a sustainable economic recovery.

Timely data are available for a number of key indicators of domestic economic activity and demand in the Republic of Ireland and these are presented below as follows:

- Total employment (Chart 2.1);
- The volume of retail sales (Chart 2.2);
- Changes in real average weekly earnings from employment (Chart 2.3);
- Changes in the real value of total domestic demand (Chart 2.4); and

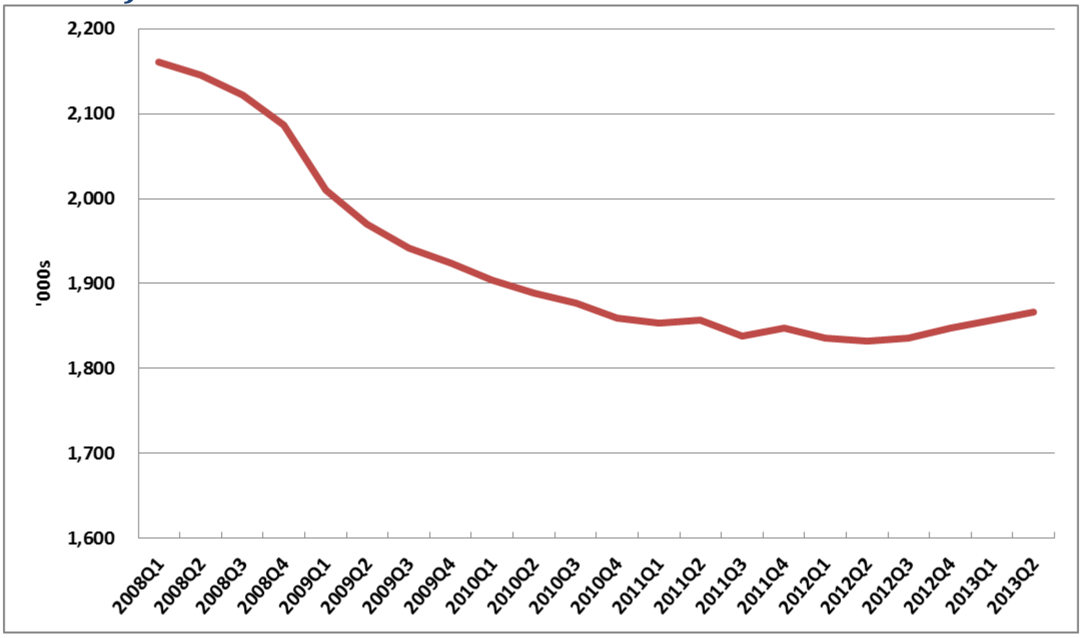
[6] Central Bank of Ireland (2013b) Residential Mortgage Arrears and Repossessions Statistics: Q2 2013.

– Changes in the volume of exports (Chart 2.5).

Collectively they illustrate an economy that remains subdued after a severe contraction in the early phase of recession in 2008 and 2009. The inflection in the employment data (chart 2.1) in late 2012 points towards improvements in job opportunities, but the time series in the chart highlights how significantly employment has fallen since the recession commenced. However, it is of note that employment in the Republic is growing while employment in Portugal, Spain and Greece continued to decline.

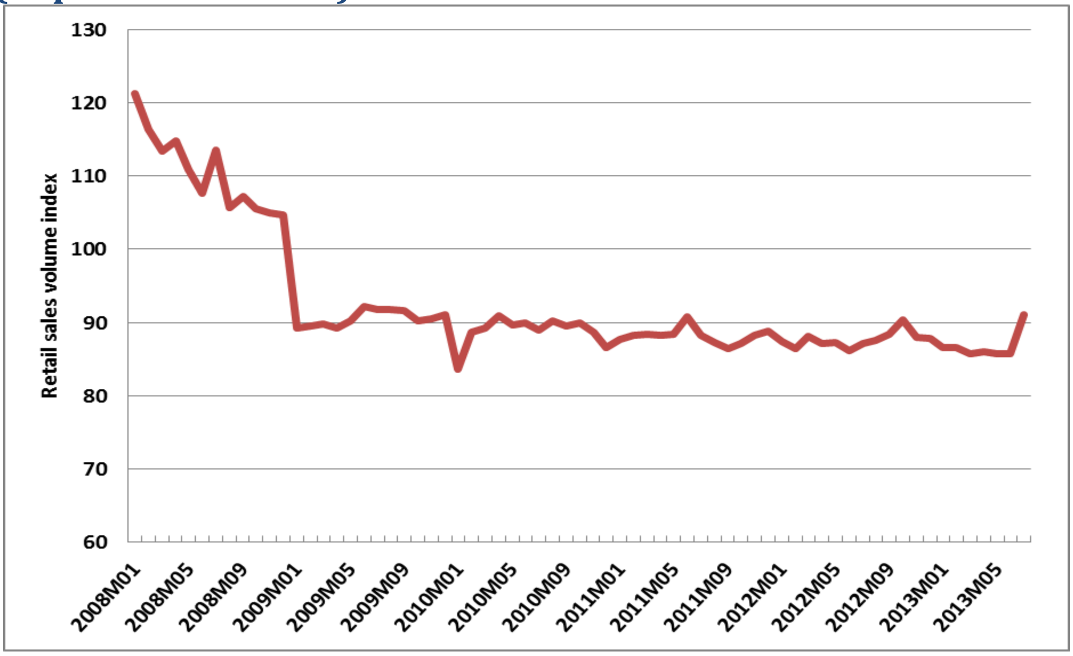
The real value of earnings has also stabilised but at a level notably below rates over most of the past five years. Similarly, domestic demand and retail sales have ceased their rapid decline but remain fragile and subdued. Finally, chart 2.5 highlights the growth in exports which have been key to the Republic experiencing any economic growth over recent years. The aforementioned decline in late 2012, driven by a decrease in good exports, remains a key concern and area of uncertainty.

Chart 2.1 Quarterly Trends in Total Employment (Republic of Ireland)



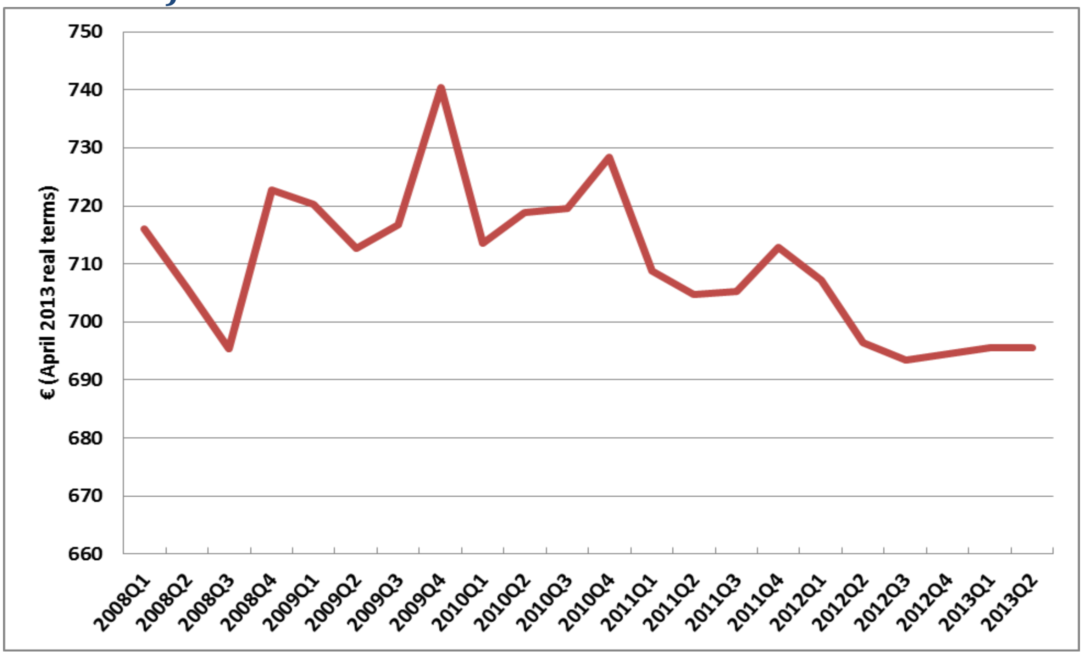
Source: CSO Quarterly National Household Survey (reference code from CSO StatBank is QNQ03)
Note: Total employment seasonally adjusted.

Chart 2.2 Monthly Trends in the Volume of Retail Sales (Republic of Ireland)



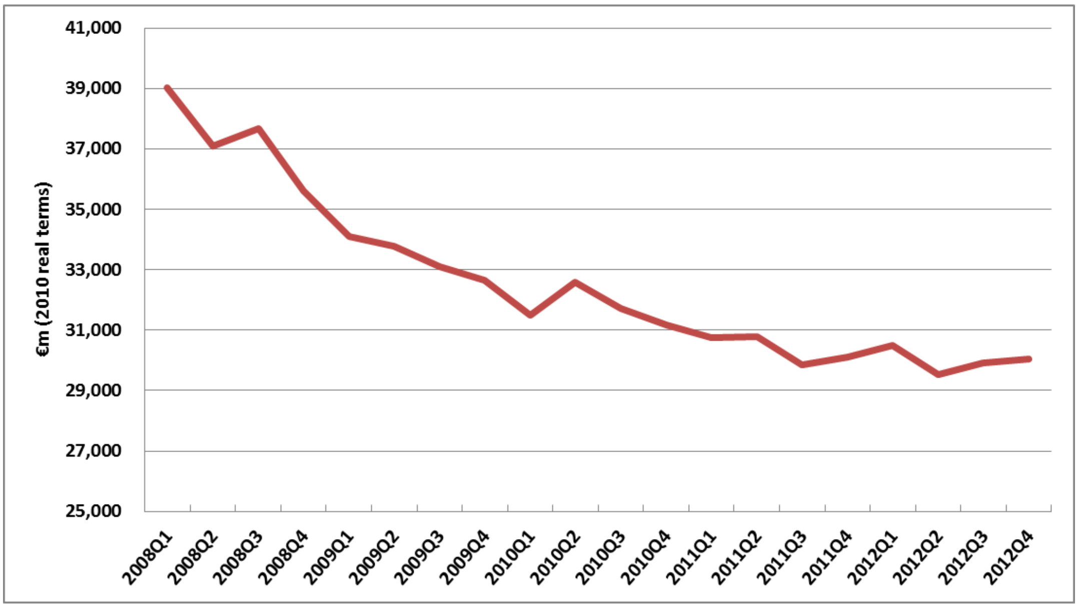
Source: CSO Retail Sales Index (StatBank code RSM03)
Note: Volume of retail sales (seasonally adjusted)

Chart 2.3 Changes in Real Average Weekly Earnings (Republic of Ireland)



Sources: Source: CSO survey on Earnings Hours and Employment Costs (EHQ08); CSO EU Harmonised Index of Consumer Prices (CPM05)
Note: Values expressed in April 2013 prices.

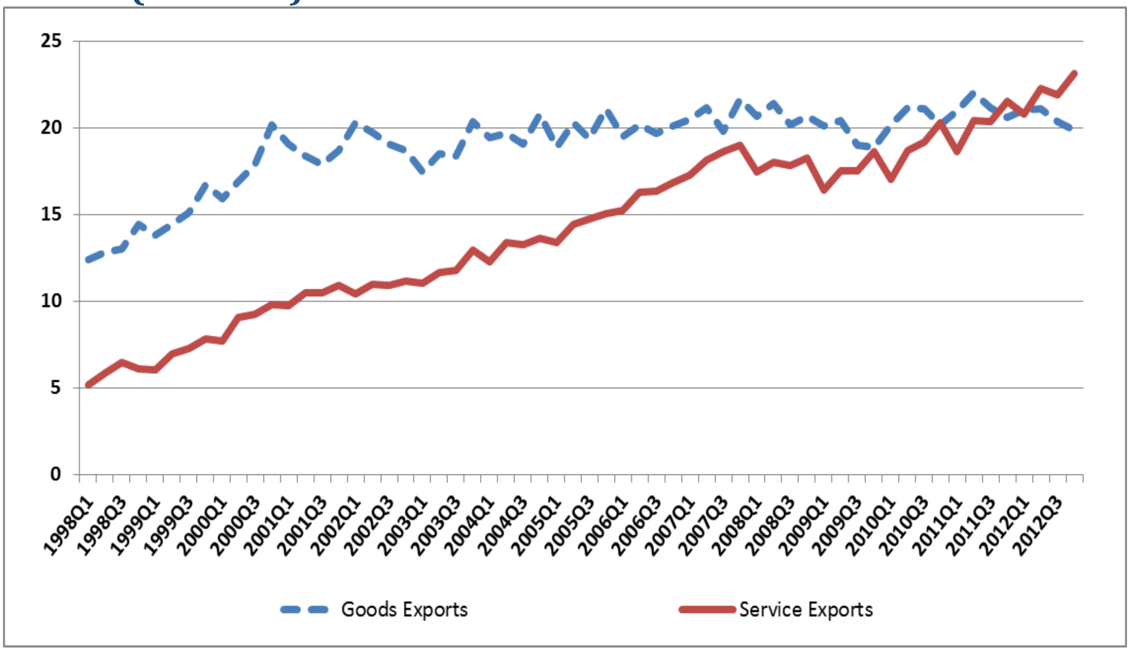
Chart 2.4 Trends in the real value of domestic demand (Republic of Ireland) (€m)



Source: CSO: Quarterly National Accounts.

Notes: Final Domestic Demand = Personal Consumption + Government Consumption + Investment. Domestic demand chiefly differs from Gross Domestic Product due to the size of net exports = exports – imports, and changes in values of physical stocks. All values have been adjusted for seasonal variation.

Chart 2.5 Trends in the Volume of Exports – Republic of Ireland(€ billion)



Source: Central Statistics Office, Quarterly National Accounts.

2.3 Northern Ireland

Recent data on the Northern Ireland (NI) economy has been mixed. The most recent Ulster Bank purchasing managers index (PMI) data indicate a pick-up in the services sector most notably in retail from July and August. That sector also saw increases in employment; a welcome development given it was the area of the economy that saw the largest fall in employee numbers during the crisis, after the construction industry. However, it will take further data over the remainder of the year to determine whether this is a sustained increase or has been influenced by the impact of recent one-off events such as the Police and Fire games in Belfast and the World Fleadh in Derry. Elsewhere, the PMI points to reductions in construction sector orders; a trend confirmed by recent data from a Royal Institute of Chartered Surveyors (2013) survey that also indicates further contraction ahead.

House prices in Northern Ireland recorded their first across the board increases in the period of the three months to the end of July (NISRA, 2013). Additional data later in the year will indicate if the housing market has found a floor. It is worth noting that the current house price to earnings ratio in NI has only just returned to long term UK trend level (Nationwide Building Society, 2012). Future house prices increases can only be sustainable if wages grow as well.

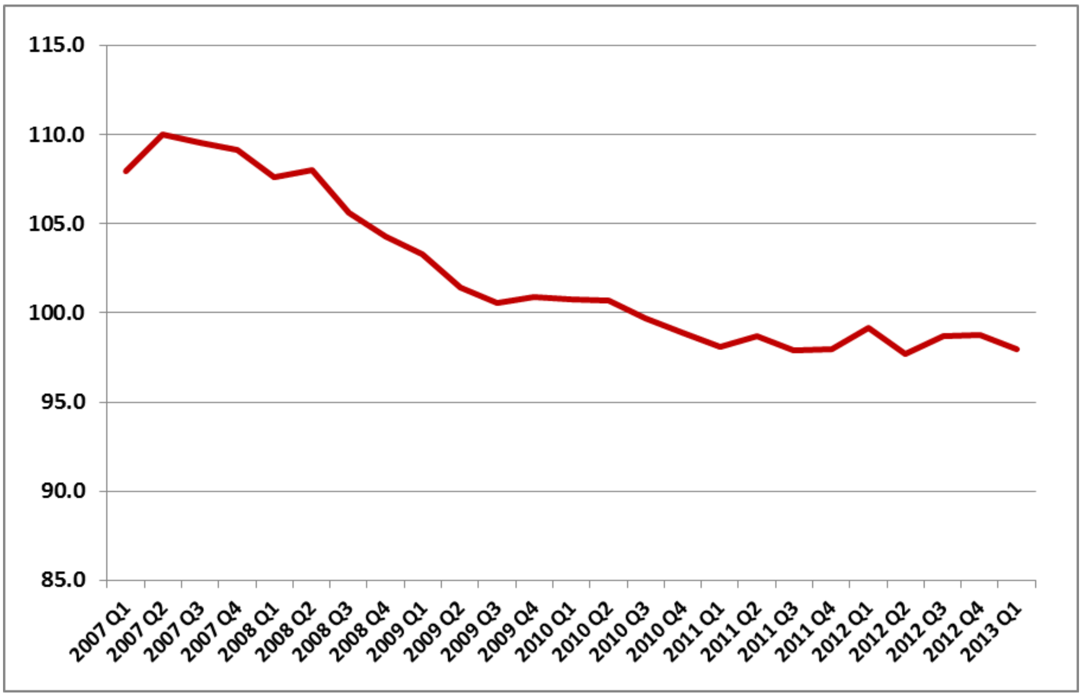
Figures for NI foreign direct investment (FDI) from UK Trade & Investment (2013) show a welcome increase although these improvements contrast with a stagnant domestic economy – see chart 2.6 below.

At a UK level claims of economic recovery remain premature. As highlighted earlier, recent GDP increases are small and overall GDP remains 3.3% below its pre-crisis peak. In the medium to long-term it should be remembered that the quality of growth matters as much as its quantity. Given the current public policy mix, with the introduction of the "Help to Buy" housing scheme and a decrease in both real wages and the UK saving rate, there remains some concern that the UK economy could be heading towards a debt fuelled consumption bubble coupled with an over-inflated housing market – conditions that contributed to the previous recession.

Earlier this year the Northern Ireland Statistics Research Agency (NISRA) released, on a trial basis, a new index referred to as the Northern Ireland Composite Economic

Index (NICEI) which measures overall economic activity in Northern Ireland.[7] The Index for Northern Ireland shows a contraction of -0.8% in the first quarter of 2013. This recent data and the trends in the NICEI since 2007 are summarised in chart 2.6.

Chart 2.6 Trends in the Northern Ireland Composite Economic Index



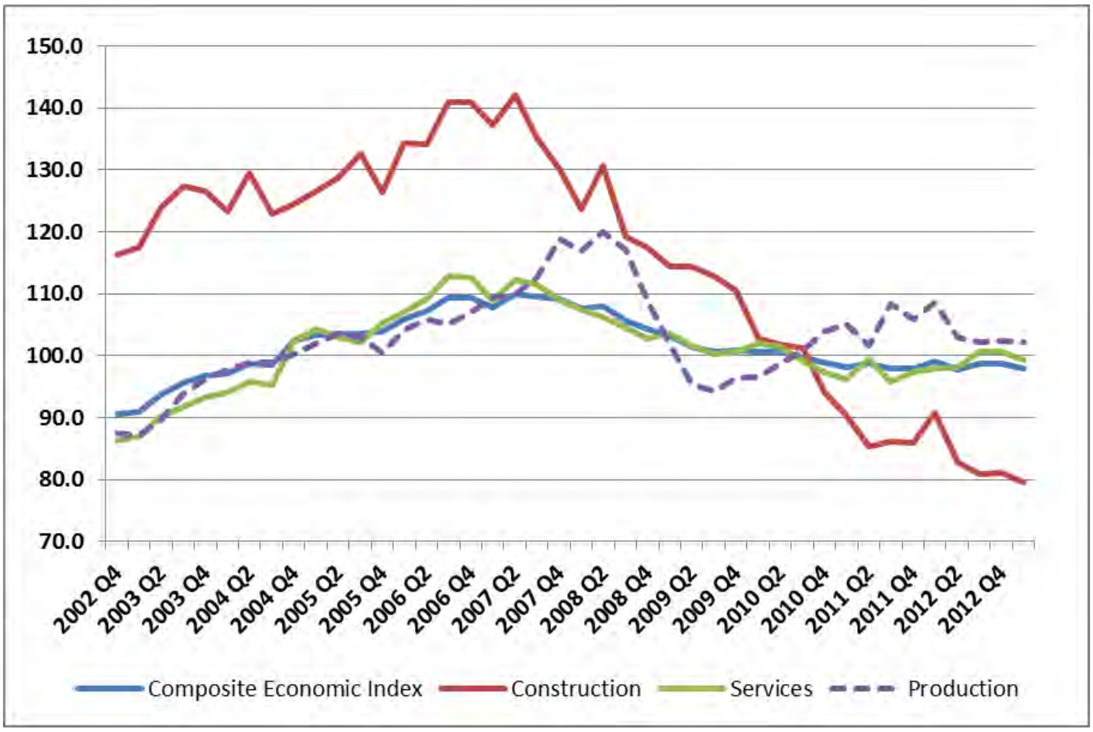
Source: Northern Ireland Statistics and Research Agency (2013)

Charts 2.7 and 2.8 disaggregate the NICEI to examine trends and recent performance in various sectors. The most recent data, reflected in chart 2.7, shows Q1 2013 declines in the construction sector, reflecting the trends highlighted earlier, and records a decrease of 1.4% in the service sector; so the positive data cited earlier may only be compensating for prior poor performance. Chart 2.8 shows the breakdown of activity for the public and private sector. It shows that from 2002 until 2007/08 public sector activity increased moderately while the bulk of growth in the composite index was driven by a rapid expansion in the private sector. The private sector reached its peak in the second quarter of 2007, as did the composite index, while public sector reached its peak in the third quarter of 2009. The most recent data shows that public sector

[7] In the absence of full national accounts data at a regional level, the Northern Ireland Composite Economic Index (NICEI) provides an overall measure of production. The NICEI is a quarterly measure of output similar to the production approach to calculating National income and making use of survey data where gaps exist. A similar index was constructed for the UK using the same methodology, and this index tracked UK GDP almost exactly over the last number of years.

growth remains flat, and all of the decrease in economic activity is emanating from the private sector.

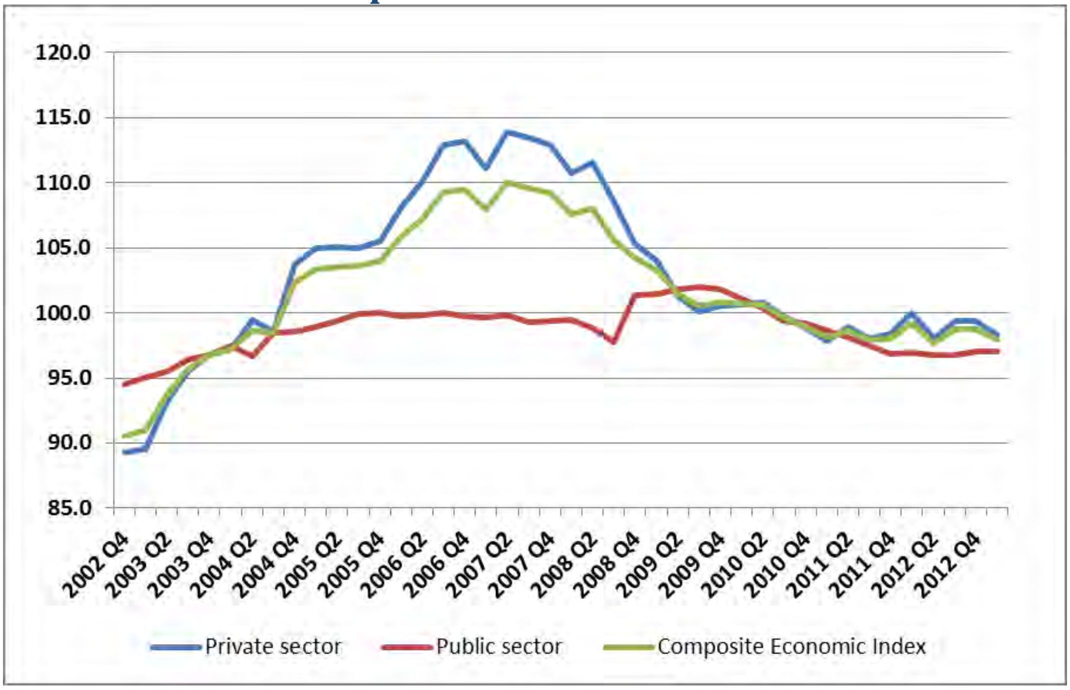
Chart 2.7 Sectoral change in the Northern Ireland Composite Economic Index



Source: Northern Ireland Statistics and Research Agency (2013)

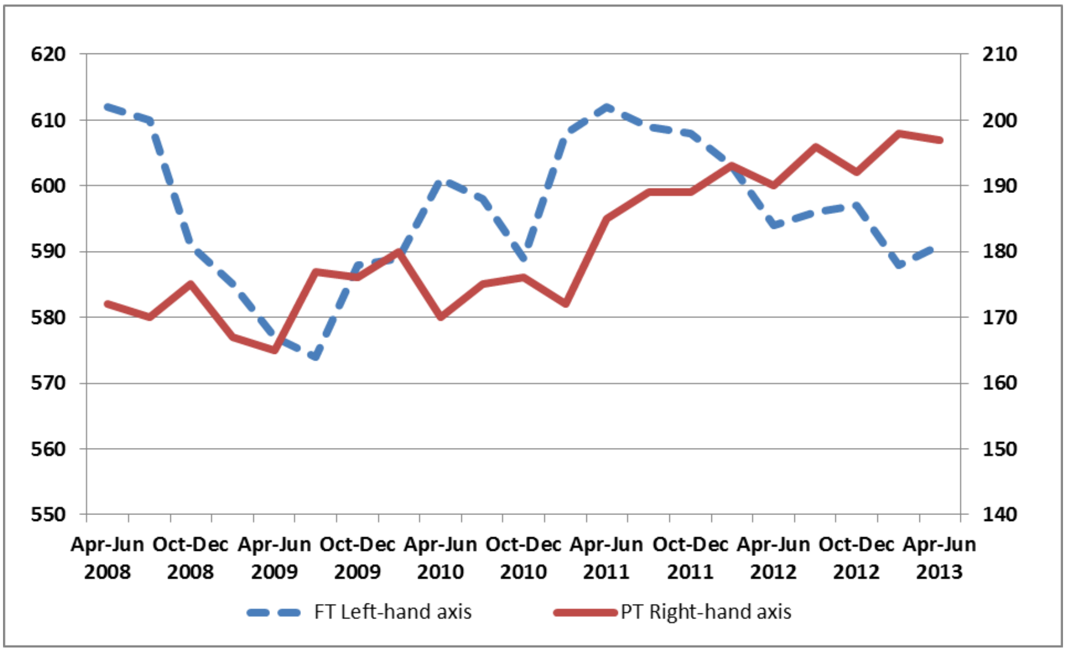
To date, the 2013 performance of the NI labour market has been mixed. Unemployment is down significantly to 6.9% for three months to the end of July. It is worth bearing in mind that monthly unemployment figures in Northern Ireland are presented in three month blocks and are subject to substantial variation. For instance, unemployment for the three months from February to April was 7.8% and the rate was 7.5% from April to June. What we can say from these figures is that unemployment has been gradually decreasing over the last number of months, but that this trend is also coupled with increasing economic inactivity that could be creating an artificially low level of unemployment (this point is further explored in Section 3).

Chart 2.8 Public and private sector performance in the Northern Ireland Composite Economic Index



Source: Northern Ireland Statistics and Research Agency (2013)

Chart 2.9 Full and Part-time employment, Northern Ireland 2008-2013 (000's of individuals)



Source: NISRA (LFS Quarterly Supplement)

Table 2.2 serves as a new addition to the NERI QEO and brings together data on enterprise and business, skills, labour and infrastructure in Northern Ireland. Over future editions, we plan to develop this table as a method of expanding our assessments of trends and developments within the Northern Ireland economy. Of note within the sections of the table are the following points:

Enterprise & Business

- Northern Ireland remains dominated by SMEs and particularly single operator firms. Within the UK, it has the largest proportion of firms engaged in construction sector of any region.
- R&D spending has been one of the few successes of Northern Ireland private sector, particularly among domestic firms. In contrast, the fall-off in state and Higher Education R&D is of concern to the regions long-term growth prospects.

Skills

- The proportion of those with no formal qualifications continues to increasing among working age population in Northern Ireland. However, this category is decreasing among those in unemployment.
- The data suggests a welcome increase in school attainment at GCSE and A-level. Numbers transitioning from school to employment have halved in the last four years, a trend which may explain increases in those going on the further and higher education.

Labour

- The fall in real wages in Northern Ireland ties in with a UK wide squeeze on living standards. To date, productivity increases have not fed into wage growth.
- Northern Ireland has a much lower wage profile than the UK as a whole. The majority of this gap is accounted for by relatively low full time wages for males.
- Vacancies almost halved over the crisis period (2008-2011) with redundancies showing much more fluctuation over same period.

Infrastructure

- The Northern Ireland electricity market continues to depend on imports from Scotland. However there have been notable increases in the amount of electricity generated by renewable sources within Northern Ireland with output almost tripling between 2008-2012.

- Northern Ireland housing completions halved over the recession period while the Residential House Price Index has fallen by almost a third.

Table 2.2 Some key economic trends in Northern Ireland, 2008-2012

	2008	2009	2010	2011	2012
Enterprise & Business					
No of Business	-	-	121,000	122,000	114,000
% of Businesses in Construction	-	-	22.8	23.8	22.9
Business Births	5,655	3,945	4,590	3,745	-
Business Deaths	4,175	5,170	5,230	4,950	-
No. of Businesses with no employees	-	-	85,440	88,475	81,000
No. of Businesses 500+ employees	-	-	55	55	50
Research & Development Expenditure	367.8	509.5	535.4	567.5	-
R&D Enterprises	196.6	341.6	353.2	388.8	-
% R&D Foreign owned firms	60.3	26.8	32	26	-
% R&D Domestic owned firms	39.7	73.2	68	74	-
R&D Higher Education	154.2	150.9	166.1	164.3	-
R&D Government	17	17	16	14.4	-
Patents applied for	253	213	240	249	252
Patents granted	11	11	7	16	23
No. of Tourists (International and GB)*	-	-	-	1.56m	1.55m
Skills					
% Working Age Pop. with Degree	-	19	19	18.5	19.0
% Working Age Pop. with Higher Ed (below degree)		7	8	5.3	7.4
% Working Age Pop. with A-level	-	26	25	20.8	25.0
% Working Age Pop. with GCSE	-	20	22	28.2	22.5
% Working Age Pop. other quals	-	7	6	4.5	6.1
% Working Age Pop. no quals		12	20	22.7	20.0
% Employed with Degree	24	25	24	24.8	25.6
% Employed with Higher Ed(below degree)	9	8	9	6.9	9.0
% Employed with A-level	25	26	25	22.8	26.5
% Employed with GCSE	21	20	21	26.0	20.8
% Employed other quals	6	7	7	5.1	5.8
% Employed. no quals	15	15	13	14.5	12.3
% School Leavers with 2+ A levels	44.6	46.3	50.2	52.7	53.3
% School leavers with 5 GCSE's	88.7	89.7	91.3	92.8	93.5
% School leavers with No GCSE's	3.9	3.6	2.9	2.1	2.2
% School leavers with No Formal quals	3	2.8	2.3	1.7	1.9
% School leavers to Higher Ed	38.5	39.9	42.9	42.2	41.7
% School leavers to Further Ed	27.4	29.5	32.4	33.1	32.6
% School leavers to Employment	12.1	10.2	6.7	7	6.6
% School leavers to Unemployment	3.3	3.5	3.1	3.6	3.8
% School leavers to Training	15.9	14.8	12.7	11.8	13.1
% School leavers to Unknown	2.8	2	2.1	2.4	2.2

Table 2.2 Some key economic trends in Northern Ireland (continued)

	2008	2009	2010	2011	2012
Labour					
Productivity (GVA per head)	16,117	15,635	16,203	16,531	-
Median Gross Weekly Pay	345.0	354.6	354.7	354.5	360.2
Real % change in Productivity	2.9	5.1	-0.5	0.3	-
Real % change in Median gross pay	1.3	0.5	-3.1	-2.4	0.1
Median Gross Pay Male Full time	439.8	460.0	455.6	461.8	478.9
Median Gross Pay Female Full time	385.2	402.6	409.4	417.9	440
Median Gross Pay Male Part time	139.9	150.0	132.4	139.2	139.0
Median Gross Pay Female Part time	152.6	161.4	152.2	154.4	153.8
No. of Vacancies	83,119	56,351	51,469	47,107	-
No. of Redundancies	2,782	4,596	2,096	1,808	3.354
Infrastructure					
Electricity Imported	545	1,937	2,297	1,769	-
% Electricity from renewables	5.0	7.3	9.3	8.9	14.3
Housing Completion	13,477	9,722	9,745	7,694	6,800
Residential Property Price Index	152.5	124.5	119.8	103.8	90.75

Sources: Department for Business Innovation and Skills (2012) Business Population Estimates for the UK and Regions 2012 BIS: London Northern Ireland Statistics and Research Agency (2013) Northern Ireland Residential Property Price Index Quarter 2 2013 NISRA: Belfast Northern Ireland Statistics and Research Agency (2013) LFS Quarterly Supplement Northern Ireland Statistics and Research Agency (2012) Northern Ireland Research & Development Statistics 2011 NISRA: Belfast Intellectual Property Office (2013) The Patent Office Annual Report and Accounts 2012/13 IPO: London Northern Ireland Statistics and Research Agency (2013) Great Britain and Other Overseas Visitors to Northern Ireland 2012 NISRA: Belfast Department of Education (2013) Qualifications and Destinations of Northern Ireland School Leavers 2011/12 DENI: Belfast Office for National Statistics (2012) Regional Gross Value Added Income Approach ONS: London Northern Ireland Statistics and Research Agency (2012) Annual Survey of Hours and Earnings NISRA: Belfast Northern Ireland Statistics and Research Agency (2012) Vacancies in Northern Ireland: Statistics from 2007 to 2012 NISRA: Belfast Northern Ireland Statistics and Research Agency (2012) Northern Ireland Redundancy Statistics NISRA: Belfast Office for National Statistics (2012) Generation and supply of electricity in Scotland, Wales, Northern Ireland and England, 2004 to 2011 ONS: London Northern Ireland Statistics and Research Agency (2013) Northern Ireland Housing Statistics 2011-12 NISRA: Belfast Northern Ireland Statistics and Research Agency (2013) Northern Ireland Environmental Statistics Report NISRA: Belfast

Note: *Tourisim numbers exclude domestic visits within NI and visits from the ROI.

3 Macroeconomic Projections

This section of the QEO outlines our outlook for the economies of both parts of the island of Ireland. For the Republic, we report a set of projections out to 2016 and include our expectations for national income and its components, employment growth, unemployment and Government finances. In the case of Northern Ireland our outlook is based on a review of the regions recent economic data (see section 2) and the policy and political context likely to impact on its performance. As in previous editions we compare our expectations to those from some other agencies in relation to output and employment.

The mixed national and international economic signals of recent times sets the context for these assessments. Compared to our analysis in Summer 2013, our expectations for economic growth are largely unchanged although we are revising upwards our labour market expectations for the Republic.

The section is structured as follows:

- assumptions in regard to international developments;
- economic projections for the Republic of Ireland; and
- economic outlook for Northern Ireland.

3.1 Macroeconomic Assumptions for the Global Economy

As noted in the previous section, there remains considerable uncertainty regarding the speed and scale of economic recovery in European economies and in international economies generally. Among those countries and regions that are key trading partners for the economies of the island of Ireland, the outlook is for slow but gradual growth. However, as the OECD noted in their recent *Interim Economic Assessment* (September 2013a) "a sustainable recovery is not yet firmly established" and "important risks remain".

Within Europe, instability persists associated with the continents debt crisis and the fiscal challenges facing a number of peripheral countries. The potential for renewed uncertainty over the US government's debt ceiling also offers the prospect of instability. The UK economy, significant for both parts of the island, remains weak albeit that its growth outlook is improving.

Elsewhere, plans and speculation related to the unwinding of market supports by central banks is encouraging uncertainty and altering the economic outlook. While growth remains strong in various emerging economies, its pace is slowing, carrying possible implications for capital flows, trade and economic activity generally. As these emerging economies have fuelled much of the world's economic growth over recent years, their slowdown is significant; although it may be offset by gradual growth elsewhere. Collectively, this implies a fragile and sluggish outlook for the international economy. It also serves as a challenging context for export growth – the key driver over recent times of economic growth in the Republic.

Medium-term risks remain, in particular for those 'advanced economies' at the heart of the recent financial crisis. The OECD's interim assessment notes two challenges facing these regions (i) high unemployment which may lead to structural unemployment even as the recovery takes hold; and (ii) persistently weak investment in advanced economies which has slowed capital growth, risks impeding productivity growth during the recovery and serves as a further drag on domestic demand (OECD, 2013a).

Overall, the international outlook remains weak but positive and fragile.

3.3 Macroeconomic Projections for the Republic of Ireland

The aforementioned recent improvements to the labour market represent a significant development for the Republic of Ireland's economy and impact on our macroeconomic projections outlined in table 3.1. The expectations and trends reflected in these projections are outlined below.

Gross Domestic Product

Compared to our projections in Summer (June), our expectation for GDP growth and the performance of its components remains unchanged. We anticipate sluggish growth in 2013 and 2014, at 1.0% and 1.2% respectively, with rates climbing to 1.8% in 2015 and 3% in 2016. Within the components of GDP our expectations are as follows:

Personal Consumption: We anticipate that personal consumption will contract this year (-0.4%) and remain flat in 2014 before slowly recovering as austerity policies are reduced. In the short term, household budgets remain under strain as a result of increases in living costs, real-value declines in wages and transfers and the introduction and increase in costs of mandatory household charges (property taxes and water charges). Indications from retail turnover figures (generally weak) and exchequer VAT returns (below target) suggest that reductions in spending is one of the routes households have adopted to absorb these direct and indirect living cost increases. Elsewhere, households continue to deleverage – prioritising the reduction in debt over spending. As the major component of the domestic economy, this sustained weakness in personal consumption weighs heavily against greater activity within the domestic economy.

Investment: Uncertainty and the challenges of accessing credit will impede growth in investment in 2013 (+0.8%). Ireland, like other advanced economies cited by the OECD earlier, continues to considerably under-invest relative to historical norms; a phenomenon recently explored in an NERI paper by Duggan (2013). We anticipate increases in investment from 2014 with growth rates climbing to around 4% reflecting, among other factors, the impact of the various Government investment programmes (stimulus) announced during 2012 and 2013. Our projections suggest investment will be a key driver of the recovery in economic growth in the years to come. However, there remains potential for this area of economic activity to increase further if Government and other agencies begin to make use of the recently established Ireland Strategic Investment Funds (ISIF) within the auspices of the National Pension Reserve Fund (NPRF).

Government consumption: Our projections for Government current spending reflect the policy directions outlined by the Department of Finance (2013a) in the April 2013 Stability Programme Update (SPU). Exchequer spending will continue to contract to 2015 with some stabilisation in its real value in 2016.

Exports: Both investment and the export sector continue to be the driving force within the Republic's macroeconomy. While the challenging external environment adds some uncertainty to our outlook for exports, we anticipate modest export growth over 2013-2015.

Imports: The performance of the export sector represents a key influence of the scale and growth of imports; much of Ireland's exports are import intensive. Accompanying this, household consumption and investment impact on import levels. We anticipate limited growth in 2013, reflecting depressed economic conditions, but real increases of around 2.5% over 2014-2016.

Table 3.1 Projections of Output, Public Finances and Labour Market (Republic of Ireland) to 2016

	2012 values	2012	2013	2014	2015	2016
National Income		*Percentage change over previous year*				
Gross Domestic Product	€163.9bn	0.2	1.0	1.2	1.8	3.0
Personal Consumption	€82.6bn	-0.3	-0.4	0.0	0.9	1.7
Investment	€17.4bn	-1.0	0.8	4.1	4.1	4.1
Government Consumption	€25.1bn	-3.7	-1.0	-2.0	-1.5	0.2
Exports	€176.7bn	1.6	2.0	2.9	3.0	3.5
Imports	€136.9bn	0.0	1.0	2.4	2.5	2.6
Government Finances		*Percentage of GDP*				
General Government Deficit		-7.6	-6.8	-4.6	-3.1	-2.4
Gross Debt	€192.4bn	117.6	123.6	122.3	120.9	116.0
Labour Force		*Percentage change over previous year*				
Employment	1,837,800	-0.6	1.4	1.7	2.2	2.8
		Percentage of Labour Force				
Unemployment	316,000	14.7	13.8	13.3	12.8	12.1

Notes: 2012 data from CSO National Accounts and Eurostat Labour Force Survey. 2013-2016 data are NERI projections.

Labour Market[8]

Employment growth: While there are some caveats associated with the aforementioned positive developments in employment (see section 2), our expectation is that 2013 will see net job creation of 1.4%. We anticipate that increases in growth, investment and the slow recovery in personal consumption will drive further employment growth out to 2016. Our employment projections adopt the ILO employment definition – working for pay, profit or in a family business for one or more hours in a week – and do not distinguish between any part-time/full-time split in employment growth.

[8] See our Summer 2013 *Quarterly Economic Observer* for details on the population and labour market projections underpinning these labour market projections.

Unemployment: Driven by job creation, increases to training places and emigration, we expect the rate of unemployment to fall to an average of 13.8% for this year (2013). Over the year from 2012, unemployment will have fallen by almost 1%, some 17,000-20,000 individuals. Reflecting the earlier growth and employment projections, and developments in community employment and other active labour market policies, we project further decreases in unemployment out to 2016. At that point, our expectation is for an unemployment rate of 12.1% - still more than twice the pre-crisis level.

Government Finances

Relative to our previous assessments of the Republic's economy, our most significant revisions are to our outlook for the Government's finances. While our expectations for growth are unchanged from Summer 2013, the aforementioned labour market developments have notable implications for exchequer finances. Reductions in the numbers unemployed translate into expenditure reductions for the Department of Social Protection while employment increases generate additional direct and indirect tax revenue flows. Collectively, these feed through to lower deficit and debt outcomes.

Our expectation is for an end-of-year budget deficit of 6.8% of GDP – better than the Governments April 2013 target of 7.4%. While we are not as optimistic as the Department of Finance regarding reductions to the budget deficit out to 2015, given current policy plans, we expect a deficit of 4.6% in 2014 and 3.1% in 2015 (Department of Finance (2013a:6) project 2014=4.3% and 2015=2.2%). The 2015 figure is marginally above the Troika budget deficit target.

The Republic's gross debt will climb to exceed €200 billion by the end 2013; we expect an end-of-year figure of €207 billion or 123.6% of GDP. We expect the 2013 figure to represent the peak of the debt-GDP ratio and anticipate this falling out to 2016.

Table 3.2 compares our projections to those of other agencies. Projections of GDP growth in 2013 vary between a low of 0.7% (Central Bank) and a high of 1.8% (ESRI). The NERI 2014 projection is at the lower end of the forecast spectrum at 1.2% within a range of 1.2-2.7%. Among those agencies projecting GDP growth for 2015, the NERI projection is the lowest. Conversely, our figure for 2016 is among the highest reflecting our view that a moderation in fiscal austerity in 2016 is likely to have a beneficial impact in that year.

Table 3.2 Overview of recent projections of change in real GDP (Republic of Ireland)

	2011	2012	2013	2014	2015	2016
Outcomes	**2.2**	**0.2**				
Projections						
NERI	-	0.3	1.0	1.2	1.8	3.0
Department of Finance	1.7	0.9	1.3	2.4	2.8	2.7
Central Bank	2.4	0.5	0.7	2.1	-	-
EU Commission	0.9	0.4	1.1	2.2	-	-
IMF	2.3	0.4	1.1	2.2	2.7	2.7
OECD	1.5	0.1	0.0	1.9	-	-
ESRI (QEC)	1.4	1.3	1.8	2.7	-	-
Ernst and Young	1.1	0.0	0.8	2.2	2.6	3.0
Investec (formerly NCB)	1.0	0.3	1.2	2.0	2.2	2.7

Sources: Department of Finance Stability Programme Update (April 2013) (Department of Finance, 2013); Central Bank: Quarterly Bulletin (July 2013); European Commission European Economic Forecast: Spring 2013 (May 2013); International Monetary Fund: Tenth Review Under the Extended Arrangement (June, International Monetary Fund, 2013); OECD: Economic Survey of Ireland 2013; ESRI: Quarterly Economic Commentary (Spring 2013) (Duffy and Timoney 2013); Ernst and Young (2013); Investec: Irish Economy Monitor (June 2013).

Notes: Data sources for Outcomes: Central Statistics Office and Eurostat.
Previous forecasts for 2011-2012: Forecasts made at the end of the previous year (2010 and 2011, respectively, for 2011and 2012)
Current forecasts for 2013-2016 as of August/September 2013 or the most recent period.

Table 3.3 Overview of recent projections of unemployment as % labour force (Republic of Ireland)

	2011	2012	2013	2014	2015	2016
Outcomes	**14.7**	**14.7**				
Projections						
NERI	-	14.9	13.8	13.3	12.8	12.1
Department of Finance	13.2	14.9	14.0	13.3	12.8	12.3
Central Bank	13.3	14.8	13.7	13.2	-	-
EU Commission	13.5	14.8	14.2	13.7	-	-
IMF	13.0	14.8	14.1	13.7	12.9	12.4
OECD	13.6	14.8	14.3	14.1	-	-
ESRI (QEC)	13.5	14.8	14.2	13.9	-	-
Ernst and Young	12.7	14.9	14.0	13.7	13.3	12.4
Investec (formerly NCB)	13.0	14.2	14.2	13.3	11.4	10.4

Sources: See table 3.2.
Notes: See table 3.2.

Various projections for the rate of unemployment are compared in Table 3.3. The better-than-expected improvements in the numbers unemployed during 2013 will result in all agencies revising their expectations – as we do in this edition of the QEO. In time, we expect others to revise their expectations for lower unemployment levels out to 2016. Of those who project to 2016, only Investec (formerly NCB) report a lower rate than the NERI.

Risks to the forecast

Our forecasts above have been formed on the basis of available data and expectations, based on past trends, of the behaviour of key macroeconomic indicators in the future. Like all forecasts, uncertainties with regard to future international and domestic trends serve as a risk to the reliability of our projections.

Internationally, the fragility of European and US economic growth coupled with uncertainty regarding future growth prospects in developing economies point towards a potential risk. Higher or lower growth in these areas could emerge and have notable knock on implications for the Republic's macroeconomy. These might emerge from further European banking and sovereign debt issues, European interest rate increases, energy prices increases, international political tensions (particularly in the Middle East) and expectations of the withdrawal of central bank market supports. Political tensions surrounding fiscal debt ceilings in the US may also impact.

Domestically, our forecasts would be altered by unexpected development in the Euro-Sterling exchange rate, further exchequer requirements to fund capital injections into the commercial banks and any interruption to the investment stimulus plans Government have set out for 2014 and onwards. While we expect household spending to remain static in real terms in 2014, there is a risk that the austerity measures in Budget 2014 combined with the scheduled doubling of the local property taxes (versus 2013) may drag household spending lower. In previous years, there has been a pronounced negative effect on household spending and domestic activity in the early part of the year following similar large budgets.

The sustainability of some recent trends could also impact on our forecasts. Changes to employment growth and migration trends would have consequences for our labour market projections. Similarly, the sustainability of the recent recovery in tourism numbers will depend on factors including the weather in 2014.

3.4 Macroeconomic Outlook for Northern Ireland

The outlook for the Northern Ireland economy is closely tied to developments in the broader fiscal, trade and monetary circumstances of the UK economy. Previously, in Summer 2013, we outlined expectations for a 1% reduction in output, measured by the NI composite economic index (NICEI), during 2013. Initial figures for Q1 2013 suggest a -0.8% contraction in the index, in particular driven by the continued poor performance of the construction sector and declines to services (DETINI, 2013:5).

Looking to the future, expectations for future growth are dependent on the nature of the fledgling UK 'recovery'. Recent data has been encouraging, but it will take another few quarters to determine whether growth is sustainable (ONS, 2013). There remains a danger that the recovery to date is a short-term blip, which is being buttressed by rising confidence. Confidence from consumers and the wealth effect of increasing house prices and/or confidence from business owing to a perception that the worst of the crisis is over. In either case, these assumptions are volatile and vulnerable to sudden change. The spatial distribution of any recovery across UK regions also remains an issue. If activity remains confined to South East England, Northern Ireland and other peripheral regions could miss out.

Table 3.4 Overview of recent projections of Economic Activity and employment/unemployment (Northern Ireland)

	2011	2012	2013	2014	2015
Outcome (GVA)	0.0	-	-	-	-
Outcome (NICEI)	-1.8	-0.1	-	-	-
Outcome (Employment)	2.9	0.3	-	-	-
Outcome (Unemployment)	7.2	7.5	-	-	-
Economic Activity					
NERI (NICEI)	-	-	-1.0	-	-
Ernst & Young (GVA)	0.5	-0.8	0.2	1.7	2.2
PWC (GVA)	0.3	-0.3	0.5	1.5	-
Danske Bank (GVA)	-	-0.8	0.5	1.7	-
Employment					
Ernst & Young	-2.6	-1.7	-0.6	0.1	0.3
Unemployment % Labour Force					
Danske Bank	7.3	7.6	8.2	-	-
Ernst & Young	7.4	7.6	8.3	8.5	8.3

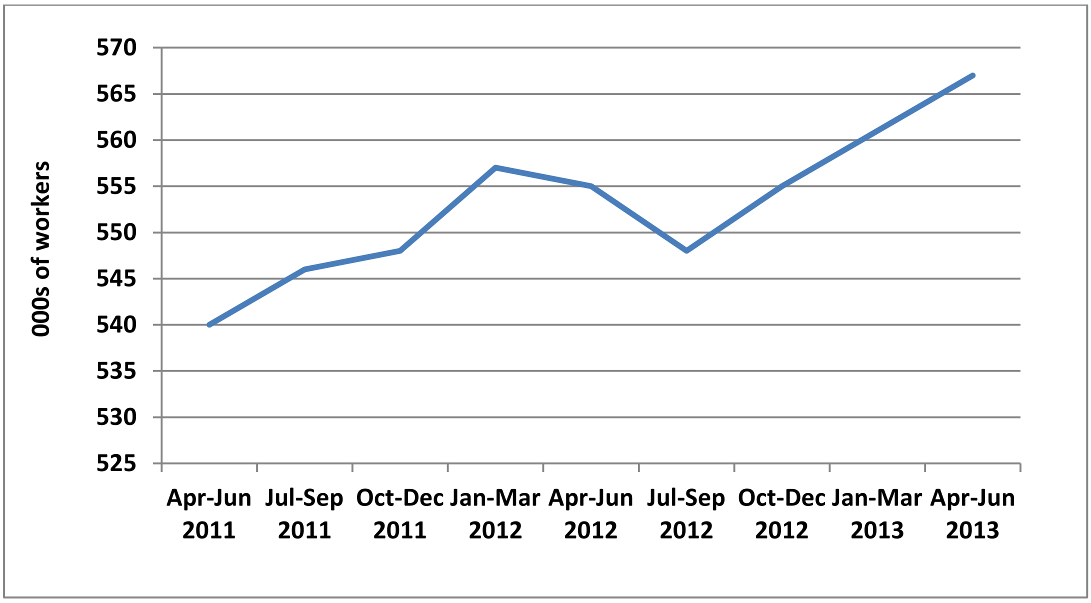
Sources: Ernst and Young: Economic Eye, Summer (2013); PWC: Economic Outlook August (2013); Danske Bank Economic Overview June (2013); Danske Bank Quarterly Sectoral Forecast August (2013)

Note: Gross Value Added differs from GDP by the difference between taxes and government subsidies.

Table 3.4 brings together a number of recent projections for economic activity, employment and unemployment in Northern Ireland. Using the gross value added (GVA) measure, expectations are for small increases in economic activity in 2013 and 2014.

Within the labour market, Table 3.4 outlines expectations for small changes to both employment and unemployment. Impacting on the unemployment numbers has been recent trends in the number of people classified as economically inactive – see Chart 3.1. It is worth noting that if this trend continues there is a possibility that it will drive down headline unemployment rates although limited progress would be made in additional employment and activation.

Chart 3.1 Trends in the numbers of Economicaly Inactive People in Northern Ireland, April 2011-June 2013



Source: Labour Force Survey (April- June 2013) DETI
Note: Age 16+

4 Budget 2014, Income Taxes and High Earners[9]

4.1 Introduction

The composition of the fiscal adjustment planned for the forthcoming Budget 2014 (October 2013) remains a domestic policy choice. Under the terms of the Memorandum of Understanding with the Troika, Ireland is required to reach a budget deficit target of 3% of GDP by 2015. Our expectation is for an end of year budget deficit of 6.8% of GDP in 2013 (see Table 3.1) implying further adjustment measures in Budget's 2014 and 2015 so that the target can be met.

In our Summer 2013 *Quarterly Economic Observer*, the NERI outlined a proposal for an alternative fiscal adjustment; one which differed from the expenditure reduction orientated pathway Government has signalled it plans to follow. Our proposals demonstrate that there are choices open to Government and it is possible to pursue a jobs-friendly, growth-friendly and equality-friendly fiscal adjustment. At the core of our suggestions were three points:

(i) Government should use the €1 billion of savings from the Anglo Irish Promissory Note restructuring earlier this year to reduce the scale of the planned budget adjustment. The savings represent reductions in planned expenditure on debt service costs and it would be appropriate to count them as such.

(ii) The remaining adjustment should be re-orientated towards taxation measures with the only expenditure cuts being those already agreed and announced under the two public sector wage agreements. As we explore further below, there remains potential for those on the highest incomes to contribute more in taxation to the adjustment. Similarly, there is potential for a greater contribution from corporate taxes, wealth taxes, employers' PRSI and capital taxes. Overall, tax increases would represent just over 80% of the adjustment.

(iii) Government should recognise that no matter how it undertakes its adjustment, the domestic economy will continue to struggle to grow. To overcome this, the Budget should include an investment stimulus targeted at key deficits and job

[9] This section of the QEO draws on a recent NERI Working Paper from Collins (2013a) entitled '*Income Taxes and Income Tax Options – a context for Budget 2014*'.

intensive sectors of the domestic economy. Areas including water infrastructure, broadband connectivity, green energy, early childhood education facilities are obvious targets. These represent opportunities for investments which will deliver large returns in the medium-term alongside immediate benefits to the state in additional jobs, increases in taxation revenues and reduced welfare costs. The NERI proposal is for a €1.5 billion stimulus in 2014 and €3 billion stimulus in 2015.

Table 4.1 summarises the composition of the fiscal adjustment we proposed in Summer 2013 and compares this to that previously outlined by the Department of Finance. Overall, the NERI proposal is for a €2 billion adjustment in 2014 and €1 billion in 2015 accompanied by a fiscal stimulus; this compares to a Department of Finance adjustment plan of €3.1 billion and €2 billion for those years. Our analysis also examined the macroeconomic implications of pursuing this course, demonstrating that Government would still meet its 2015 budget deficit target. Relative to the planned adjustment, the NERI's approach is more growth friendly and job intensive (NERI, 2013: 32-45).

Table 4.1 Proposed Fiscal Consolidations compared - 2014 and 2015 (€ billion)

	Dept. of Finance		NERI	
	2014	2015	2014	2015
Reductions in current expenditure	1.90	1.30	0.35	0.30
Reductions in capital expenditure	0.10*	0.00	0.00	0.00
Total Expenditure Reductions	**2.00**	**1.30**	**0.35**	**0.30**
Total Revenue Increases**	**1.10**	**0.70**	**1.65**	**0.70**
Overall Budget Adjustment	**3.10**	**2.00**	**2.00**	**1.00**
Investment Stimulus			1.50	3.00
Projected Budget Deficit	**-4.3**	**-2.2**	**-4.8**	**-3.0**

Source: Department of Finance (2013a: 6 ,22) and NERI (2013: 39)
Notes: * The proposed 2014 capital expenditure reduction has subsequently been deferred by Government.
** including new and carry-over measures.

The NERI proposal differs in suggesting that just over 80% of the 2014 adjustment should be made through revenue increases, compared to 35% from the Department of Finance. Similarly, we have argued that the adjustment planned for 2015 should be revenue orientated with this accounting for 70% of that adjustment. In our Summer

2013 *Quarterly Economic Observer*, we outlined and discussed the composition of the proposed revenue adjustments and this is summarised in table 4.2.

Table 4.2 NERI's proposed additional tax measure in Budgets 2014 and 2015 (€ million)*

	2014	2015
Revenue 'carry-over' from previous year's budget**	600	100
Changes to income taxes	400	200
Wealth tax	150	150
Employer Pay-related Social Insurance	100	100
Corporation Tax	250	100
Capital Gains Tax	100	-
Capital Acquisition Tax	50	50
Total	**1,650**	**700**

Source: NERI (2013: 36)
Notes: * See the NERI's Summer 2013 Quarterly Economic Observer which discussed each of these potential revenue sources (2013: 35-36, 39-44)..
** Data from the Department of Finance SPU April 2013.

Aside from the effect of revenue 'carry-over' from the 2013 Budget, the largest component of the proposed adjustment comes from additional income taxes. We suggest that these should raise an additional €400 million in 2014 and €200 million in 2015. Given the aforementioned weakness of the domestic economy, any adjustments to individual and household incomes are likely to have knock-on consequences for growth and recovery. In that context, our proposal for tax increases has focused on limiting the negative growth implications of any such changes. We therefore suggest tax increases at the top of the income distribution, where households have greater capacity to absorb these increases. Lower down, as evidenced by the sustained underperformance of exchequer VAT receipts so far in 2013, households would seem to be absorbing increases in taxes, in particular indirect taxes such as the property tax, through spending reductions.[10]

While it is impossible to avoid any knock-on spending and economic activity impacts from our proposed income tax changes (this is the case for any composition of fiscal adjustment), the focus at the top of the income distribution is intended to minimise these effects. Simply, the revenue raising is focused on those most able to carry these increases. Furthermore, alternative choices such as consumption tax increases, or

[10] See Department of Finance, End of Month Tax Receipts (2013b).

expenditure cuts, are likely to be more regressive and have a more substantial negative impact on the domestic economy.[11] We outline the capacity for, and details of, these increases in the next section.

4.2 Income and Income Taxation

The Income Distribution

The analysis in this section draws on the NERI's analysis of the current Republic of Ireland taxation system. Complementing this, the structure of the income distribution and many of the tax revenue estimates below come from the forthcoming NERI Republic of Ireland microeconomic model which is being developed to facilitate assessments of trends and policy options on issues including earnings, welfare and taxation. The model, and the analysis here, draws from an examination of the micro data from the Central Statistics Office's (CSO, 2013a) 2011 Survey on Income and Living Conditions (SILC). This survey is part of an EU wide household living standards survey and collects income and living standards information from a representative national sample. In 2011 the dataset comprised responses from 11,005 individuals in 4,333 households.[12]

Like all survey data sources, the SILC dataset, and consequently any analysis drawn from it, is subject to some caveats. In particular, income surveys tend to experience lower response rates from high income households, a feature which may bias down some of the revenue estimates reported later. Similarly, successful sampling can be challenging among low-income households and minorities while those in institutions are excluded from the sample. However, the SILC data remains the most detailed and robust data source available for Irish individual and household income and offers the most comprehensive method for examining policy options such as those explored in this paper.

A further challenge is that the SILC data used in the assessments below are for 2011 while the policies under consideration are for 2014 and later years. The impact of this

[11] See Barrett and Wall (2005) and Collins (2011) who discuss the income distribution impact of indirect taxation measures.
[12] The data include a probability weight variable to correct for under-representation and non-response and these weights are used in the analysis below. The collected income data are reconciled by the CSO with tax records in an attempt to ensure its accuracy. See Collins (2013b) for more information on the 2011 income distribution.

difference on the representativeness of the results below depends on how significantly the profile of earners, and in particular high income earners, has changed between 2011 and 2014. Table 4.3 offers an insight from the Revenue Commissioners published and preliminary data for 2010-2012. It suggests limited change in the number of high income tax cases over that period implying some stability in the number of individuals likely to be impacted by the proposals outlined below.

Table 4.3: Summary of the Distribution of Tax Cases by Gross Income - Revenue Commissioners, 2010-2012

Gross Income Range €	2010	2011	2012
0 -75,000	1,886,867	1,955,039	1,947,402
75,001-100,000	102,146	104,238	104,875
100,001+	99,430	103,351	104,552
Total cases	**2,088,443**	**2,162,628**	**2,156,829**

Sources: Revenue Commissioners (2012) and Parliamentary Question reply 14th May 2013
Notes: Data is for tax cases rather than individuals. Tax cases may comprise one individual or two individuals jointly assessed. Revenue Commissioners do not provide a method for distinguishing between tax cases of different sizes.

Using the SILC data, we can examine the income and taxation levels of households classified into deciles. Deciles represent 10% groups of the population ranging from the 10% of households with the lowest gross income to the 10% of households with the highest gross income.[13] Within these deciles household income varies. Average decile figures are reported later (table 4.5) while table 4.4 reports the weekly and annual gross income thresholds, or entry points, for each of the deciles.

At the bottom of the income distribution, a household is recorded as in the lowest decile if it reports a weekly gross income of less than €253 (€13,226 per annum) while at the top of the income distribution households above a weekly gross income of €2,089 (€108,997 per annum) reside in the top 10% of Ireland's income distribution.

[13] For an individual, gross income includes all income flowing to that person in the form of cash and non-cash earnings, self-employment income, pension income, investment income, social transfers, employer pension contributions, employer health/life insurance/assurance contributions and employers social contributions. A household's gross income is the sum of these individual income components for all household members.

Table 4.4: Household Deciles Gross Income Thresholds/Entry-points, 2011

		Gross Household Income	
Decile		**Weekly €**	**Annual €**
Bottom	Gross income ***below***	253	13,226
2	Gross income ***above***	253	13,226
3	Gross income ***above***	352	18,363
4	Gross income ***above***	474	24,731
5	Gross income ***above***	594	31,011
6	Gross income ***above***	742	38,704
7	Gross income ***above***	924	48,200
8	Gross income ***above***	1,190	62,104
9	Gross income ***above***	1,534	80,019
Top	Gross income ***above***	2,089	108,997

Source: Calculated by author using NERI Microeconomic model and based on microdata from CSO's 2011 SILC survey.

Notes: Values rounded for presentation purposes.
Income data is non-equivalised.

Income and Taxation – effective tax rates

Using the SILC data it is possible to examine the scale of income taxation paid by households across the income distribution. Comparing the total of income taxes (including social insurance) with total gross income, an effective taxation rate can be calculated. These rates best reflect the true scale of contributions made by households and individuals in income taxes and incorporate the various tax credits, rates, bands and exemptions which typify the income tax system. At is simplest; a household with a gross income of €50,000 that pays a total of €10,000 in income taxes, USC and PRSI reports an effective taxation rate of 20%.

Table 4.5 outlines the results of this analysis. On average Irish households experience a mean annual gross income of almost €53,000 and have an effective tax rate of 14.44%. Collins (2013a:7) reports that over the past number of years the average effective tax rate for households has increased from 12.8% in 2007 and 13.5% in 2010. Across the income distribution, the effective rates reflect the progressivity of the income taxation system with very small contributions from households with the lowest incomes and the bulk of income taxation flowing from households from the 4th decile and above. At the top of the income distribution, the top 10% of households pay an average of 25.64% of their gross income in income taxes.[14]

Table 4.5: Gross Income, Income Tax Paid and Effective Tax Rates, by household decile 2011

Decile	Average Annual Gross Income €	Average Annual Tax and SI paid €	Average Effective Tax %
Bottom	8,675.89	18.27	0.21%
2	15,317.67	28.21	0.18%
3	21,949.04	145.04	0.66%
4	27,852.17	483.51	1.74%
5	34,795.24	980.41	2.82%
6	43,264.32	2,555.49	5.91%
7	55,139.07	5,422.09	9.83%
8	70,347.16	9,336.24	13.27%
9	93,277.24	16,739.83	17.95%
Top	159,018.00	40,767.51	25.64%
Mean annual	**52,949.46**	**7,644.31**	**14.44%**
Mean weekly	**1,014.75**	**146.50**	**14.44%**

Source: Collins (2013a) using CSO SILC data.
Note: Table 7.3.1 in the appendix provides corresponding figures for 5% groups of the household population.

The data cited in Table 4.5 uses the formal definition of gross income as the basis for its calculations. This definition is as used by Eurostat and the Central Statistics Office (CSO). For an individual, gross income includes all income flowing to that person in the form of cash and non-cash earnings, self-employment income, pension income, investment income, social transfers, employer pension contributions, employer health/life insurance/assurance contributions and employers' social contributions. A household's gross income is the sum of these individual income components for all household members. In his examination of these data trends for Ireland, Collins (2013a:31) notes that it can be argued that employer's social contributions differ from the other sources in that, although it is an element of establishing an individual's entitlement to social insurance, the flow of income is implicit. An adjustment to effective taxation rates to account for this reflects the concentration of earnings

[14] In his analysis of this data, and both household and individual effective tax rates, Collins (2013a:9) compares the results of the SILC analysis with Revenue Commissioner data on effective tax rates and find the data offer similar results.

towards the top of the income distribution and alters the effective tax rates by between 0.25% and 1.6% for households in the top five deciles. Under such an income definition the rate for the 9th and top decile is 19.14% and 27.25% respectively.

The effective tax rates in Table 4.5 suggest the potential for additional contributions from income taxes from households across the income distribution. Collins notes that in time, via increases in social insurance and income taxes, this is likely to be a source of additional tax revenue for government – flowing from almost all households and individuals bar those on the lowest of incomes. However, achieving any such changes will be a challenging public policy pathway in the years to come (2013a: 10).

In the short-term, the severity of the recent recession and its impact on household incomes across the board has been large and has significantly altered living standards. In that context, and as mentioned earlier, we consider that the options for increased taxation from across the income distribution are likely to have narrowed with the primary potential being with those at the top of the income distribution. The remainder of this section explores the revenue potential and some options for achieving this additional revenue.

4.3 High Earners and Income Taxation Options

This section explores the potential and possible options for raising additional taxation revenue from those at the top of the income distribution. Initially we examine the scale of revenue that could be achieved from small increases in the effective taxation rates of households in the top decile – above a gross income of €109,000 per annum. Subsequently, we briefly outline some policy options which could contribute to achieving this additional revenue.

Within the top 10% of households, there is a broad range of gross household income levels. While the entry point for the top 10% is almost €109,000, the average income among that group is €159,000 (see table 4.5). Looking at the top 5% of households, those with a gross income above €140,000, the average income is €197,000 suggesting a large number of high income households within that group (see table 7.3.1 in the appendix).

Table 4.6: Summary of Revenue Commissioners Gross Income Data, 2012 (updated from base year 2009)

Income Range €	No of cases	Average annual Gross Income
0-15,000	579,164	7,000
15,001-20,000	198,371	17,564
20,001-30,000	386,339	24,823
30,001-40,000	295,068	34,767
40,001-80,000	510,980	55,210
80,001-90,000	48,173	84,690
90,001-100,000	33,515	94,728
100,001-120,000	41,890	108,986
120,001-140,000	23,114	129,078
140,001-160,000	13,140	149,184
160,001-180,000	8,029	169,289
180,001-200,000	5,350	189,357
200,001-250,000	8,071	221,991
250,001-300,000	4,322	272,384
300,001-350,000	2,631	323,288
350,001-400,000	1,630	373,139
400,001-450,000	1,161	423,585
450,001-500,000	815	473,878
500,001-750,000	2,030	600,239
750,001-1,000,000	647	853,870
1,000,001-2,000,000	537	1,305,854
Over 2,000,000	120	8,612,150
Total Cases	**2,165,097**	

Source: Calculated from Revenue Commissioners PQ reply, 2012.
Note: Data are for tax cases rather than individuals or households. Tax cases may comprise one individual or two individuals jointly assessed. Revenue Commissioners do not provide a method for distinguishing between tax cases of different sizes.

The latest Revenue Commissioner data also offers an insight into this distribution. The data, summarised in table 4.6, is for tax cases (one individual or a jointly assessed couple) rather than households and is 2009 data updated to represent Revenue's projections for 2012. At the top of the income distribution, there are 22,000 tax cases above €200,000 including 3,300 above €500,000.

While we propose focusing taxation measures at the top 10% of the income distribution, within that decile there is potential for the increases to be progressive – raising more from households with higher incomes.

Additional Taxation Revenue

Reforms in previous Budgets, in particular those related to limiting the scale of pension contributions, are already contributing to raising additional revenues from those at the top of the income distribution. However, even given these changes, effective tax rates among these households will continue to demonstrate room for increase.

Table 4.7 returns to the aforementioned target of raising an additional €400 million in 2014 and €200 million in 2015 (Table 4.2) from high income households. These revenue amounts could be achieved by any of the following increases to effective taxation rates. We can examine possible scenarios for the top 10% overall and within that decile for those in the top 5% of households and those in the 5% immediately lower down.

Table 4.7: Raising €600 million in additional taxation revenue from the top 10% of households

	Overall Increase in revenue	Annual Amount per household	Weekly Amount per household
The top 10% of households			
2014			
1.5% increase for top decile	***€400m***	€2,380	€46
2015			
0.8% increase for top decile	***€200m***	€1,270	€24
The top two 5% household groups			
2014			
2.0% increase for top 5%	€300m	€3,900	€76
1.0% increase for second 5%	€100m	€1,200	€24
	€400m		
2015			
1.0% increase for top 5%	€150m	€1,950	€38
0.5% increase for second 5%	€50m	€610	€12
	€200m		

Source: Calculated by author using NERI Microeconomic model and based on microdata from CSO's 2011 SILC survey.
Note: Calculations have been rounded.

There are a number of alternatives open to government to implement these additional income tax increases. For example, there remains some potential to reform the structure and scope of the minimum effective tax rates applicable under the high earners restriction. A lower entry point to that restriction (currently €125,000) alongside a broader definition of 'adjusted income' on which it is calculated and an increase in the target effective rate (from the current 30%) would significantly contribute towards reaching the targets set out in table 4.7. Similarly, further reforms to the structure and availability of tax breaks, a number of which are predominantly availed of by high earners, would contribute toward raising this additional taxation revenue.[15] In either case, the marginal tax rates of households would remain unchanged.

4.4 Conclusion

Government's decisions regarding the composition of the forthcoming fiscal adjustment planned for Budget 2014, irrespective of its final size, is of significant importance for Ireland's short and medium-term socio-economic outlook. An expenditure orientated adjustment, as the Government currently plans, will of necessity further reduce the provision of public services across the board, and most particularly in the major exchequer spending areas of health, education and social protection. Combined with the agreed set of public sector paybill reductions and planned tax increases, the Budget has the potential to further deflate an already struggling domestic economy and undermine what progress there has been in economic activity and employment.

Our recommendation is for an alternatively structured budget, with no expenditure cuts beyond those already agreed for public sector pay, the use of the promissory note savings to reduce the budgets scale, a targeted Investment stimulus and the focusing of the remainder of the adjustment on tax increases. Of these, we believe that the largest increases should come from income taxes with the possibility of additional revenues of €600 million (€400m in 2015 and €200m in 2016) coming from small increases in the effective taxation rates of the highest income households.

[15] See Collins (2013a) who develops these points and examines a number of potential revenue sources.

5 Conclusion

Mixed signals and uncertainty are the dominant theme for the economic outlook in the international economy and both parts of the island of Ireland. The legacy of the fiscal retrenchment over the past few years continues to persist. North and South, domestic activity is weak, exports are under pressure, investment is unsustainably low, unemployment is high and growth is limited.

Looking to the future, we are optimistic for the Republic's labour market, but caution that any 'improvements', driven by job creation and migration, should be considered in the context of ongoing high levels of unemployment, youth unemployment and long-term unemployment. Public policy needs to be formed in a way which addresses these challenges alongside encouraging investment, broader economic activity and recovery. Our proposals for the Republic's 2014 Budget reflect this, suggesting a smaller fiscal adjustment than that proposed by Government (€2 billion rather than €3.1 billion), an investment stimulus and a reorientation of the fiscal adjustment away from expenditure cuts towards tax increases. In section 4 we focused on the potential to raise additional revenue in income taxes from those at the top of the income distribution. While none of these choices are easy, policy needs to be formed in a way which, in as much as is possible, supports and encourages recovery in the domestic economy.

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7 Appendix

Appendix 7.1. Overview of key economic trends – Republic of Ireland

	2008	2009	2010	2011	2012
Total Expenditure					
Consumption €m	94,162	83,294	82,200	82,380	82,634
Investment: private and public €m	39,620	26,096	19,293	17,266	17,434
Government current spending €m	30,371	29,304	26,196	25,701	25,096
Exports €m	150,181	146,369	157,810	166,964	176,736
Imports €m	-133,877	-120,352	-128,326	-131,840	-136,990
Domestic Demand €m	163,822	137,205	127,122	126,332	125,540
Total Income					
GDP €m	180,249	162,284	158,097	162,600	163,938
GNP €m	154,933	133,919	131,812	130,662	132,649
Income from Agriculture €m	2,708	2,066	2,580	3,179	2,876
Income non-Agriculture: Wages €m	81,856	74,454	69,221	68,315	68,390
Income non-Agriculture: Other €m	48,427	43,042	48,840	54,073	52,885
Employment					
Labour Force	2,300,100	2,242,400	2,196,700	2,173,700	2,165,800
Labour Force Participation Rate %	64.2%	62.3%	61.0%	60.4%	60.2%
Employment	2,136,400	1,953,600	1,886,100	1,845,600	1,841,300
Employment full-time	1,735,300	1,530,800	1,459,700	1,411,300	1,395,000
Employment part-time	401,100	422,700	426,400	434,300	446,300
Underemployment	95,200	112,900	112,500	140,800	147,600
Unemployment	163,700	288,900	310,600	328,100	324,500
Unemployment %	7.1%	12.9%	14.1%	15.1%	15.0%
Long-term Unemployment	42,000	80,600	152,600	191,700	193,000
Long-term Unemployment %	1.8%	3.6%	6.9%	8.8%	8.9%
Migration					
Immigration	73,700	41,800	53,300	52,700	55,890
Emigration	72,000	69,200	80,600	87,100	88,989
Net Migration	1,600	-27,500	-27,400	-34,400	-33,099

	2008	2009	2010	2011	2012
Public Finances					
Total General Gov. spending €m	77,009	78,384	103,404	76,548	68,832
Total General Gov. revenue €m	63,853	56,020	55,120	55,415	56,593
General Gov. Balance €bn	-13.2	-22.4	-48.3	-21.1	-12.2
General Gov. Gross Debt €bn	79.6	104.5	144.2	169.2	192.5
General Gov. Gross Debt % GDP	44.5%	64.8%	92.1%	106.4%	117.6%
Earnings and Prices					
Average earnings € per week	696.72	699.10	693.70	687.67	691.93
Average earnings % change	n/a	0.3%	-0.8%	-0.9%	0.6%
Private sector av. earn. % change	n/a	3.6%	-2.4%	-2.5%	1.0%
Public sector av. earn. % change	n/a	-2.4%	-0.8%	0.7%	1.2%
Inflation CPI %	4.1%	-4.5%	-1.0%	2.6%	1.7%
Inflation HCPI %	3.1%	-1.7%	-1.6%	1.1%	2.0%
Inequality and Poverty					
Gini coefficient	30.7	29.3	31.6	31.1	n/a
Quintile ratio	4.6	4.3	4.9	4.9	n/a
Relative poverty %	14.4%	14.1%	14.7%	16.0%	n/a
Consistent poverty %	4.2%	5.5%	6.3%	6.9%	n/a
Deprivation rate %	13.8%	17.1%	22.6%	24.5%	n/a

Sources: CSO Quarterly National Accounts; CSO National Income and Expenditure; CSO Quarterly National Household Survey; CSO Population and Migration Estimates; CSO Earnings and Labour Costs; CSO Consumer Price Index; CSO SILC Reports; and Eurostat online database.

Notes: Earnings and labour market data are for Q3 in all years.
Domestic Demand is Total Domestic Demand.
National accounts data reported at current market prices.
Underemployment calculation - new series from 2008.
Public Finance data for 2012 are preliminary figures.

Appendix 7.2 Overview of key economic trends since the onset of the current economic crisis – Northern Ireland

	2008	2009	2010	2011	2012
Total Expenditure					
Personal consumption £m	-	-	-	-	-
Investment: private and public £m	-	-	-	-	-
Government consumption £m	-	-	-	-	-
Exports £m	6,443	5,347	5,531	6,008	5,726
Imports £m	5,747	5,152	5,417	5,773	5,711
Domestic Demand £m	-	-	-	-	-
Total Income					
GVA £m	28,607	27,969	29,155	29,870	-
GNP £m	-	-	-	-	-
Income from Agriculture £m	306	323	330	-	-
Income non-Agriculture: Wages £m	16,477	16,766	17,291	-	-
Income non-Agriculture: Other £m	11,823	10,881	11,537	-	-
Employment					
Labour Force	821,000	810,000	835,000	862,000	871,000
Labour Force Participation Rate	59.9%	58.5%	59.9%	61.2%	61.4%
Employment	786,000	752,000	777,000	799,000	804,000
Employment full-time	610,000	575,000	597,000	609,000	596,000
Employment part-time	170,000	177,000	174,000	189,000	196,000
Underemployment	18,000	27,000	25,000	33,000	42,000
Unemployment	34,000	58,000	58,000	62,000	67,000
Unemployment rate %	4.2%	7.1%	7.0%	7.2%	7.6%
Long-term Unemployment	14,000	19,000	27,000	26,000	36,000
Long-term as % of Unemployed	41.2%	32.8%	46.6%	41.9%	53.7%
Migration					
Immigration	30,402	25,261	24,544	23,724	23,255
Emigration	22,688	21,604	23,394	25,218	24,570
Net Migration	7,714	3,657	1,150	-1,494	-1,315

	2008	2009	2010	2011	2012
Public Finances					
Total General Gov. spending £m	19,495	20,092	19,728	19,563	-
Total General Gov. revenue £m	-	-	-	-	-
General Gov. Balance £m	-	-	-	-	-
General Gov. Debt nominal £m	-	-	-	-	-
General Gov. Debt % GDP	-	-	-	-	-
Nominal earnings and Prices					
Average earnings £ per week	345.00	354.60	354.70	354.20	360.20
Average earnings % change	4.4%	2.7%	0.0%	-0.1%	1.7%
Average earnings % change – private sector	-	-	-	-	0.2%
Average earnings % change - public sector	-	-	-	-	3.8%
Inflation CPI %	-	-	-	-	-
Inflation HCPI %	-	-	-	-	-
Inequality and Poverty					
Gini coefficient	-	-	-	-	-
Quintile ratio	-	-	-	-	-
Relative poverty %	-	-	-	-	-
Consistent poverty %	-	-	-	-	-
Deprivation rate %	-	-	-	-	-

Sources: HMT Public Expenditure Analysis 2013; HMRC RTS; ONS Gross Value Added (Income Approach); LFS Quarterly Supplement; NISRA Northern Ireland Migration Flows; NISRA Annual Survey of Hours and Earnings.

Note: Where cells are blank the data are unavailable.

Appendix 7.3 Further Data to accompany Section 4

Table 7.3.1: Gross Income, Income Tax Paid and Effective Tax Rates, by household 5% group 2011

5% Groups	Annual Gross Income €	Annual Tax and SI paid €	Effective Tax Rate %
Bottom 5%	5,534.98	16.64	0.30%
2	11,816.32	19.91	0.17%
3	14,028.84	- 4.22	-0.03%
4	16,665.56	62.13	0.37%
5	20,372.00	18.39	0.09%
6	23,531.98	272.16	1.16%
7	26,266.40	376.21	1.43%
8	29,445.14	591.30	2.01%
9	32,959.22	797.64	2.42%
10	36,620.20	1,162.07	3.17%
11	40,816.12	1,734.58	4.25%
12	45,712.83	3,376.50	7.39%
13	51,836.23	4,429.27	8.54%
14	58,423.46	6,409.36	10.97%
15	65,787.04	8,129.46	12.36%
16	74,886.79	10,537.60	14.07%
17	86,090.15	14,160.53	16.45%
18	100,446.00	19,312.54	19.23%
19	122,885.50	27,748.44	22.58%
Top 5%	197,403.50	54,598.40	27.66%
Mean annual	**52,949.46**	**7,644.31**	**14.44%**
Mean weekly	**1,014.75**	**146.50**	**14.44%**

Source: Collins (2013a: 27) using CSO SILC data.

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