Quarterly Economic Observer

Summer 2019

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NERI Nevin Economic Research Institute

About NERI and this publication

The Nevin Economic Research Institute (NERI) was 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 29th *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. Unless otherwise stated, the data cited in this Observer are the latest available as of mid-July 2019. The final draft of this document was completed on 16th July 2019.

This report has been prepared by staff of the Institute. The lead author of this QEO is Dr. Tom McDonnell. We are grateful to our 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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The Nevin Economic Research Institute

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Executive Summary

This edition of the NERI's *Quarterly Economic Observer* (QEO) outlines our latest expectations for the economies of the Republic of Ireland and Northern Ireland (Section 1) and proposes changes to the taxation of capital stocks in the Republic, in particular reforms to Local Property Tax (Section 2).

Economic Outlook for the Republic of Ireland

— The short-term outlook for the Republic's economy is positive. We now project real GDP growth of 4.6% in 2019 and 3.3% in 2020. However, this outlook is contingent on a benign outcome to the Brexit negotiations.

— Conditions in the labour market should continue to improve in the short-term with net employment growth averaging 70,000 this year. The tightening labour market will increase the bargaining power of workers. Real wages should increase by close to 2% in 2019 and 2020.

— The public finances are close to structural balance. In the event of no-deal Brexit, the automatic stabilisers and fiscal policy can be allowed to operate normally without compromising the medium-term budgetary position.

Macroeconomic performance & projections, Republic of Ireland[1]

	2018	2017	2018	2019	2020
Real Output		*Percentage real change over previous year*			
Gross Domestic Product	€321.4bn	8.1	8.2	4.6	3.3
Personal Consumption	€105.1bn	3.0	3.4	2.8	2.5
Government Consumption	€30.9bn	3.9	4.4	4.0	4.0
Investment	€73.6bn	-6.8	-21.1	6.8	7.0
Exports	€397.1bn	9.2	10.4	6.5	3.9
Imports	€285.6bn	1.1	-2.9	7.5	4.8
Earnings		*Percentage nominal change over previous year*			
Average Hourly Earnings	€23.07	1.7	2.8	3.5	3.8
Government Finances		*Percentage of GDP*			
General Government Balance	€0.1bn	-0.3	0.0	0.1	0.3
Gross Debt	€206.2bn	67.8	63.6	60.2	54.9
Labour Force		*Percentage change over previous year*			
Employment	2,258,050	2.9	2.9	3.2	1.9
		Percentage of labour force			
Unemployment	137,450	6.7	5.7	4.6	4.3

[1] Assumes a soft-Brexit outcome with a transition period until end-2020.

Economic Outlook for Northern Ireland

- The short to medium-term outlook for Northern Ireland is deeply uncertain given the possibility of a 'no deal' Brexit. Northern Ireland is the most exposed region of the UK to economic difficulties arising from Brexit.
- Present indicators of economic activity show a mixed picture, with some signs of Brexit effecting output, particularly in Manufacturing. Despite this, the labour market in Northern Ireland remains strong, showing an unemployment rate of 3.1%.
- Historically high employment rates may mask continued labour market slack linked to high rates of inactivity in Northern Ireland. The incidence of low pay remains troubling, and is concentrated in sectors such as Accommodation and food and Wholesale and Retail Trade.

Taxing property: some policy considerations

- The key objectives of any tax system are to raise a meaningful amount of revenue for the exchequer while at the same time minimising administration and compliance costs, reducing inequality, minimising economic distortions, and changing behaviour.

- The introduction of the Local Property Tax was a welcome tax reform. Taxes on immovable property such as land taxes and residential property taxes are the most growth friendly of all taxes and equitable if properly designed.

- Given the compelling theoretical arguments in favour of recurrent taxes on immovable property there is a strong case for increasing the basic rate by 0.01% or 0.02% year-on-year over a decade and for rebasing property values to current levels. Proposals to increase the complexity of the tax by applying different rates in different local authorities have little merit. Policymakers should scrap the current equalization system, while hardship issues are best resolved through a deferment system for low-income households.
- Net wealth taxes are attractive in distributional terms and taxing wealth and the wealthy can be an important element of social solidarity. However, the Republic should avoid pursuing the type of model that has tended to prevail internationally,

i.e. a model with multiple exemptions and reliefs, with a low threshold, and with a high marginal rate. The structure that will best reconcile the tension between our key objectives is one with: A) either zero or very few exemptions and reliefs, B) a relatively high tax-free allowance or threshold, and c) a flat marginal rate that is set at a low level.

— Other potential reforms are considered. These include scaling back the reliefs on Capital Acquisition Tax. One revenue neutral but potentially growth enhancing option is to shift the composition of capital taxation away from stamp duty and towards another form of capital taxation, for example, a stronger local property tax, a net wealth tax, or a land tax.

1 Economic Trends and Outlook

1.1 World

The Northern Ireland and Republic of Ireland economies are both small, open and heavily trade-dependent. Their short-term economic performances depend on that of their main trading partners, and more generally the global economy. The most important trading partners are each other, the euro area, Great Britain, and the United States (US). We show the recent economic performances for these countries and regions in Table 1.1.

Table 1.1 Dashboard of Macroeconomic Indicators, Selected Regions*

	2014	2015	2016	2017	2018	2019
Real GDP			*Percentage volume change over previous year*			
Euro area	1.4	2.1	2.0	2.4	1.8	1.3
United Kingdom	2.9	2.3	1.8	1.8	1.4	1.2
United States	2.5	2.9	1.6	2.2	2.9	2.3
Unemployment**			*Percentage of active population*			
Euro area	11.6	10.9	10.0	9.1	8.2	7.7
United Kingdom	6.1	5.3	4.8	4.4	4.0	4.1
United States	6.2	5.3	4.9	4.4	3.9	3.8
Inflation***			*Percentage annual average rate of change*			
Euro area	0.4	0.2	0.2	1.5	1.8	1.3
United Kingdom	1.5	0.0	0.7	2.7	2.5	1.8
United States	1.6	0.1	1.3	2.1	2.4	2.0
Compensation per Employee			*Percentage change from previous period*			
Euro area	1.3	1.3	1.0	1.5	2.1	1.9
United Kingdom	0.6	1.1	2.8	3.1	2.7	3.1
United States	2.9	3.1	0.9	3.1	2.7	3.0
Employment			*Percentage change from previous period*			
Euro area	0.6	1.2	1.8	1.5	1.3	0.6
United Kingdom	2.4	1.7	1.5	1.0	1.2	1.0
United States	1.7	1.7	1.7	1.3	1.6	1.2
Current Account Balance			*Percentage of Gross Domestic Product*			
Euro area	2.5	2.9	3.2	3.2	3.0	2.9
United Kingdom	-4.9	-4.9	-5.2	-3.3	-3.9	-4.2
United States	-2.1	-2.2	-2.3	-2.3	-2.3	-2.4
Fiscal Balance			*Percentage of Gross Domestic Product*			
Euro area	-2.5	-2.0	-1.6	-1.0	-0.6	-1.0
United Kingdom	-5.3	-4.2	-2.9	-1.8	-1.4	-1.3
United States	-3.7	-3.2	-3.9	-3.8	-4.3	-4.6

Notes: *2019 figures for Real GDP, Inflation, *Fiscal Balance, Unemployment Rate* and *Current Account* are latest IMF projections. Figures for *Unemployment* and *Compensation per Employee* are latest EU AMECO projections.
**Eurostat definition, ***Harmonised consumer prices (national definition for the US)

Sources: IMF: World Economic Outlook and Fiscal Monitor, EU Commission: AMECO.

Global growth weakened to 3.6 per cent in 2018. The IMF (3.3 per cent including 1.8 per cent for advanced economies), the European Commission (3.4 per cent) and the OECD (3.2 per cent) all project a further weakening of growth in 2019 as measures of industrial production, investment, and business and consumer confidence, remain weak. China growth in the second quarter was the slowest in almost 30 years and there is a concern that the global cyclical upswing of recent years is petering out.

There is considerable uncertainty in the short-term, not least related to Brexit and to ongoing trade tensions. The IMF also point to significant financial vulnerabilities associated with high levels of private and public sector debt in several countries, citing sovereign-bank doom loop risks in countries like Italy that Brexit or some other shock could trigger. The IMF projects Italy will just barely avoid a fall in output in 2019.

Even so, the IMF expects a modest pick-up in the global economy in the second half of the year supported by accommodative monetary policy from the US Federal Reserve, the European Central Bank, and other major central banks. We expect the US Federal Reserve to lower interest rates on at least one occasion this year. Looser monetary policy in advanced economies should also benefit financially stressed developing economies such as Turkey and Argentina to the extent that it reduces the risk of destabilising capital flight.

The ifo World Economic Climate Survey of economic experts points to an improvement in sentiment in the second quarter, albeit with below trend growth expectations in the short-term, and with the sentiment index still below zero. The survey of experts points to widening income inequality as the economic problem of greatest world importance.

The unemployment rate is falling in most of the major advanced economies, and the tightening labour market is facilitating wage growth and supporting household incomes and consumption. A number of economies including Japan (2.4 per cent), Germany (3.1 per cent), the Netherlands (3.3 per cent), the United States (3.6 per cent) and the United Kingdom (3.7 per cent) appear to be at full employment. This means real output growth in these countries will increasingly have to come from productivity gains.

As it happens, persistently low levels of investment in the productive capital stock augurs badly for productivity growth over the medium-term. Indeed, weak labour productivity growth, coupled with an ageing population, suggest output growth will be structurally lower in the advanced economies in the medium-term, at least in the absence of policies to boost innovation and technology diffusion.

Labour market conditions amongst Irish trading partners are relatively benign and improving. Inflation remains subdued despite the relatively strong labour market conditions and this is contributing to real wage growth. Wage growth in the Euro area was 2.5 per cent year-on-year in the first quarter of 2019 while the inflation rate averaged 1.4 per cent in the first half of the year. Annual wage growth in the UK was 3.1 per cent in April, while inflation was 2.1 per cent. Real wage growth in both the Euro area and the UK is therefore close to 1 per cent. More impressively, annual wage growth was 3.6 per cent in the US in June while annual inflation was just 1.6 per cent. Finally, annual employment growth in the Euro area was 1.2 per cent in the first quarter of 2019 with business survey data suggesting continued but slower job creation in the near term.

The outlook for the UK economy is obviously uncertain given the lack of clarity regarding Brexit. The IMF projects growth of 1.2 per cent this year while the EU Commission projects growth of 1.3 per cent. Stockpiling ahead of the first Brexit deadline gave a temporary boost to growth in the first quarter (1.8 per cent annually), which then seems to have partially unwound in the second quarter producing a dampening effect on output growth. Investment growth will remain weak until there is clarity over the post-Brexit relationship with the EU. While official forecasters' project similar growth rates of close to 1.3 per cent in 2020, we should see these forecasts as very much contingent on a soft Brexit.

A no deal outcome could plunge the UK into a recession in 2020 and cause a fall in living standards. The UK's large current account (4.2 per cent of GDP) and fiscal (1.3 per cent) deficits, suggest limited room for countercyclical fiscal policy in the event of a hard Brexit, while loosening monetary policy will add to inflation in the context of a falling Sterling. Conversely, a soft Brexit, or even a Brexit reversal, would likely induce a sharp increase in investment and output growth next year.

1.2 Republic of Ireland

Trends and analysis

Ireland's headline real GDP grew by 8.1 per cent annually in 2017 and by 8.2 per cent in 2018. However, the activities of a small number of large multinationals distort the headline figure and it is now a misleading indicator of economic activity occurring in Ireland. Even so, the economy is growing strongly. The more useful 'modified domestic demand' indicator (Table 1.2), which strips out intellectual property investment and purchases of aircraft by leasing companies grew 4.7 per cent in 2018.

The domestic Irish economy's cyclical upswing has now been ongoing for seven years and shows little sign of abatement. The unemployment rate fell to 4.5 per cent in June. Employment growth was an unsustainable 3.7 per cent in the first quarter of this year following growth of almost 3 per cent in both 2017 and 2018.

The tightening labour market is driving strong wage growth with average hourly earnings up 2.8 per cent in 2018 and average annual earnings up 3.3 per cent. However, the tightening labour market has not, as of yet, catalysed strong price inflation. The CPI grew by an average of just 1 per cent annually in the first half of 2019 following years of negligible price growth. This phenomenon of low unemployment and low inflation is also occurring in a number of other advanced economies resulting in significant real wage growth for workers.

Employment and wage growth has in turn driven strong growth in aggregate demand. Personal consumption grew 3.4 per cent annually in 2018 and then by 2.9 per cent in the first quarter of this year. Retail sales have also been growing strongly. The overall fiscal position is now reasonably solid, at least ostensibly, with a neutral headline General Government Balance (GGB) of 0.0 per cent of GDP in 2018. The year-end gross debt ratio stood at 63.6 per cent of GDP in 2018.

There is, as of yet, limited evidence of overheating in the economy. Traditional indicators such as the current account balance have lost much of their value as indicators of overheating due to the distortions to the national accounts. However, the CSO's modified current account is in surplus. In addition, price data provides little evidence of overheating while the gross savings rate is above its historical average. Finally, while recent labour market developments are extremely positive the fact remains that Ireland's employment rate (20-64) ranked just 16th in the EU in 2018 –

well below that of top performers. The fast growth in property prices reflects the ongoing mismatch between supply and demand in that sector. On the other hand, personal consumption, retail sales and average earnings are all growing relatively quickly and employment growth is well above sustainable levels.

Overall, there is little evidence the economy was overheating in 2018. In this context, our view is that the public finances (cyclically adjusted) were marginally in surplus in 2018 with a plausible range of 0.0% to 1.0% of potential output.

Table 1.2 Dashboard of Macroeconomic Indicators, Republic of Ireland

	2014	2015	2016	2017	2018	Latest
	Percentage volume change over previous year					
Gross Domestic Product	8.6	25.2	3.7	8.1	8.2	6.3 *(Q1'19)*
Modified Domestic Demand	4.2	4.5	5.8	2.8	4.7	1.5 *(Q1'19)*
Personal Consumption	2.4	3.2	5.2	3.0	3.4	2.9 *(Q1'19)*
Retail Sales	6.3	8.4	7.9	3.9	3.8	2.9 *(M1-M5'19)*
GNI* (current prices)	8.6	9.4	8.0	4.7	7.3	7.3 *(2018)*
	Percentage annual average rate of change					
Employment	2.6	3.5	3.7	2.9	2.9	3.7 *(Q1'19)*
Average Hourly Earnings	-0.3	0.2	0.8	1.7	2.8	2.3 *(Q1'19)*
Average Annual Earnings	0.2	1.2	1.3	1.9	3.3	3.4 *(Q1'19)*
Inflation (CPI)	0.2	-0.3	0.0	0.4	0.5	1.0 *(M1-M6'19)*
	Percentage of annual GDP or quarterly GDP					
Mod. Investment (% GNI*)	17.4	18.4	19.1	19.5	20.5	20.5 *(2018)*
Current Account Balance	1.1	4.4	-4.2	0.5	10.6	13.2 *(Q1'19)*
Government Balance (GGB)	-3.7	-1.9	-0.7	-0.3	0.0	-2.2 *(Q1'19)*
Gov. Gross Debt (end year)	104.1	76.8	73.4	67.8	63.6	65.6 *(Q1'19)*
	Percentage of labour force					
Unemployment (SA)	11.9	9.9	8.4	6.7	5.7	4.5 *(M6'19)*
Long-term Unemployment	6.7	5.4	4.3	3.0	2.1	1.7 *(Q1'19)*
	Percentage of households					
Deprivation	30.5	28.9	25.4	21.0	18.8	18.8 *(2017)*
At Risk of Poverty	16.2	16.7	16.3	16.2	15.7	15.7 *(2017)*
	Percentage					
Gini Coefficient	31.8	32.1	30.8	30.7	31.5	31.5 *(2017)*

Notes: Half-year, ('H'), Quarterly ('Q'), monthly ('M') and other data is compared to same period of the previous year. Rates of change represent the average value over the period. *Modified domestic demand* is non-seasonally adjusted modified final domestic demand, which we define as '*Total domestic demand less the effects of the trade in aircraft by aircraft leasing companies and the imports of intellectual property*'. *Modified investment* is the investment component of modified domestic demand. *GGB* is end-year figure as a % of annualised GDP or latest quarterly figure as % of quarterly GDP. *Unemployment* is average for four quarters or latest quarter/month seasonally adjusted.

Sources: CSO: National Income and Expenditure, Quarterly National Accounts, Retail Sales Index, Labour Force Survey, Earnings and Labour Costs, Consumer Price Index, Balance of International Payments, Government Finance Statistics, Monthly Unemployment, Survey on Income and Living Conditions,

Outlook

The most recent data suggests the economy (real GDP) grew 6.3 per cent on an annual basis in the first quarter. Exports and imports both grew by double digits, whereas modified final domestic demand grew just 1.5 per cent on an annual basis. Recent years have shown that the unpredictable tax planning activities of multinationals can exert a disproportionate and volatile influence on the growth figures and this phenomenon may be continuing into 2019.

The short-term outlook is positive and we project real GDP will grow by 4.6 per cent in 2019 and then by 3.3 per cent in 2020 (see Table 1.3). Our view is that the economy will then transition quickly to a more normal growth path of close to 2.5 per cent per annum. It is important to stress that our projections assume a soft Brexit. A 'non-Brexit' outcome represents an upside risk but at this time it appears a hard or 'no deal' Brexit is the more likely outcome. A 'no deal' Brexit would severely damage the Republic's economic performance in 2019 and beyond. Box 1.2 describes the major risks and uncertainties faced by the economy.

Table 1.3 Macroeconomic performance & projections, Republic of Ireland

	2018	2017	2018	2019	2020
Real Output		*Percentage real change over previous year*			
Gross Domestic Product	€321.4bn	8.1	8.2	4.6	3.3
Personal Consumption	€105.1bn	3.0	3.4	2.8	2.5
Government Consumption	€30.9bn	3.9	4.4	4.0	4.0
Investment	€73.6bn	-6.8	-21.1	6.8	7.0
Exports	€397.1bn	9.2	10.4	6.5	3.9
Imports	€285.6bn	1.1	-2.9	7.5	4.8
Earnings		*Percentage nominal change over previous year*			
Average Hourly Earnings	€23.07	1.7	2.8	3.5	3.8
Government Finances		*Percentage of GDP*			
General Government Balance	€0.1bn	-0.3	0.0	0.1	0.3
Gross Debt	€206.2bn	67.8	63.6	60.2	54.9
Labour Force		*Percentage change over previous year*			
Employment	2,258,050	2.9	2.9	3.2	1.9
		Percentage of labour force			
Unemployment	137,450	6.7	5.7	4.6	4.3

Notes: Projections for *Gross Domestic Product* and components refer to real economic activity; *Investment* refers to Gross Fixed Capital Formation; *Employment*, *Unemployment* and *Earnings* all represent the average value over the four quarters.
Technical assumption of offsetting or minimal further volatility to the national accounts arising from multinational tax avoidance activities. Projections based on soft-Brexit scenario.

Sources: See Table 1.2. NERI estimates for 2019-2020.

Labour market conditions should continue to improve for workers. We anticipate that strong employment growth will continue up until the end of 2020, albeit moderating from the current high levels, while the unemployment rate will continue to fall. The tightening labour market will increase the bargaining power of workers and we project that average hourly earnings will be growing at 4 per cent annually by the end of 2020. Wage growth should be fastest in expanding sectors. Price inflation will continue to rise slowly, and should be close to 2 per cent by the end of 2020. Real wages should increase by close to 2 per cent in both 2019 and 2020.

The bulk of growth over the next eighteen months will come from domestic demand with an only minimal, albeit positive, contribution from net exports. This will include a continuation of strong growth from the construction sector as supply responds to pent-up demand in the residential sector. The construction PMI was 53.1 in June. Rising costs, trade uncertainty and a weaker UK economy will all weigh on exports while imports will track domestic demand.

The economy will be overheating by the end of our forecast horizon, and perhaps even by the end of this year, assuming a benign, or at least delayed, outcome to the Brexit crisis.

The Services PMI continued at a strong pace of 56.9 in June, suggesting strong growth for this part of the economy. The strong employment and wage growth will drive demand for consumption goods from the household sector. However, the Manufacturing PMI declined below 50 in June, suggesting a possible slowdown in manufacturing activity. This may partially reflect Brexit concerns as well as an uncertain international trading environment. Consumer and producer sentiment indices have also been weakening in recent months.

The public finances should be marginally in surplus in 2019 and 2020 while the gross debt level will continue to decline as a percentage of output. A no-deal Brexit would plunge the headline general government balance into deficit. Even so, this occurrence should not precipitate a contractionary fiscal policy. Our view is that the public finances are likely to be operating from a position of marginal structural (cyclically adjusted) surplus in 2019. As such, the automatic stabilisers can be allowed to operate normally without compromising the medium-term budgetary position.

Box 1.1 Selected Macroeconomic Risks and Uncertainties: Republic of Ireland

Brexit. Brexit remains by far the most significant source of short-run uncertainty. An ESRI/Department of Finance report estimated that a disorderly Brexit would reduce output by 3 per cent versus a no-Brexit scenario after 2 years and by 5 per cent after ten years. The unemployment rate would be 0.7 percentage points higher after two years - with knock-on effects for wage growth – and 2 percentage points higher after ten years. The public finances would move back into deficit. Short-run effects could include disruption at ports, postponed investment decisions, and falling house prices as businesses and households await greater certainty. The worst affected sectors by Brexit would be those with significant export links to the UK and businesses with cross border supply chains. These include agri-food and tourism, with border and rural regions most impacted. Sterling would almost certainly depreciate thereby further reducing the competitiveness of Irish businesses as they face new tariffs on goods trade. International financial markets could come under strain.

Monetary policy and financial fragilities. The Irish economy has high public and private debt ratios meaning that a rise in interest rates would be particularly damaging to the domestic economy with a reduction in domestic demand. However, our view is that the ECB is very unlikely to increase interest rates over the next eighteen months. One reason is the fragility of the Italian economy. There are concerns that an economic crash combined with high debt levels owed to Italian banks could precipitate a sovereign-bank 'doom loop' similar to the height of the Euro zone debt crisis. Such an event would hit stock markets worldwide.

Protectionism and trade wars. US trade policy remains volatile. As a small open economy the Republic of Ireland would eventually see a reduction in living standards were there to be an increase in protectionism around the world.

Energy prices. Geopolitical tensions could cause an upward shift in energy prices. Rising energy prices would mean an increase in input costs for business and would reduce real disposable income for households. Such an event would also reduce corporate investment as well as private consumption.

International corporation tax policy. The NERI supports the momentum towards a Common Consolidated Corporate Tax Base (CCCTB)[2] as well as similar initiatives. In the context of growing inequality, social justice and solidarity considerations demand that the wealthiest make a fair contribution to public services internationally. Nevertheless, the impact on the Republic's fiscal position would be negative, with a reduction in corporation tax receipts. There could also be an effect on investment decisions, although this could actually benefit the Republic depending on the final design of the CCCTB. In any event, any impacts are likely to occur outside the forecast horizon of 2019 and 2020.

[2] CCCTB is a European Commission proposal to provide a single set of rules for how EU corporations calculate EU taxes. The proposal would make it more difficult for companies to use transfer pricing and other tax avoidance mechanisms to erode their tax liabilities.

1.3 Northern Ireland

As the Northern Ireland economy approaches the midpoint of 2019, there is cause for concern regarding short-run output growth. The economic environment could deteriorate even further over the medium term given building political momentum towards an exit from the EU without an agreement. The early indications are that the Northern Ireland economy is already experiencing negative outcomes from the ongoing Brexit uncertainty. This has already affected the manufacturing sector but there are also signs it is affecting the broader retail sector as well. While conditions in the labour market remain relatively benign, Northern Ireland remains acutely afflicted by chronic and persistent levels of low pay.

Table 1.4 Dashboard of Macroeconomic Indicators (Northern Ireland)

	2014	2015	2016	2017	2018	Latest
	Percentage volume change over previous year					
Gross Value Added	2.4	3.0	1.9	1.7	-	1.7 *(2017)*
NICEI	0.6	1.6	1.5	0.7	1.9	0.2 *(Q4 2018)*
Index of Services	0.9	1.1	2.9	1.2	0.7	0.4 *(Q1 2019)*
Index of Production	2.2	1.7	0.1	-5.9	2.3	1.7 *(Q1 2019)*
	Percentage annual average rate of change					
Employment Rate	1.8	0.2	2.1	-1.2	-0.5	0.3 (*M2-M5 '19*)
Average Hourly Earnings	-1.3	4.2	1.7	2.6	3.6	3.6 *(2019)*
Price Inflation (UK)*	1.5	0.4	1	2.6	2.3	2.4 *(M5'19)*
	Percentage of GVA					
Exports	27.2	26	25.2	25.5	-	26.6 *(2016)*
Government Spending	57.5	55.5	54.0	57.5	-	54.0*(2016)*
	Percentage of labour force					
Unemployment	6.4	6.1	5.8	4.6	3.6	2.3(*M2-M5 '19*)
Youth Unemployment	19	19.3	14.9	-		8.4 (*M8 -M10 '17*)
Long-term Unemployment	3.4	3.6	2.6	2.3	1.8	1.2 (*M2-M5 '19*)
	Percentage of population					
Relative Poverty	22	18	20	18	-	18 *(2017/18)*

Notes: Employment Rate refers to all persons in employment (ILO definition) aged 16-64 as proportion of all persons 16-64. GVA is deflated using UK GDP deflator. NI Exports refer to sales outside the UK. Exports refers to both goods and services sold from NI beyond the UK. Government Spending refers to Total identifiable expenditure on services apportioned to NI. *CPIH is now the ONS recommended measure of UK inflation.

Source: ONS Regional Gross Value Added (Income Approach); HMT GDP Deflators; NISRA Northern Ireland Composite Economic Index; NISRA Index of Production; NISRA Index of Services; NISRA Labour Force Survey; NISRA Annual Survey of Hours and Earning; ONS Consumer Price Inflation; HMT Public Expenditure Statistical Analyses; NISRA Households Below Average Income

The Northern Ireland Composite Economic Index (NICEI) grew 0.2 per cent in the final quarter of 2018, in line with UK GDP growth. The Services sector drove growth in the fourth quarter, while both the Production and Construction sectors declined. Output in the public sector saw negligible growth, as has been the case throughout 2018. Last year was a better year for the Northern Ireland economy than 2017 but as the most up-to-date figures emerge for 2019, it appears that any improvement may be short-lived. In May, UK GDP is thought to have contracted by 0.4 per cent due to a significant decline in Manufacturing output. This is due to many factors, not least the collapse in activity in UK car production. Significant plant closures began to take effect in March of this year and there were more announcements in the interim. Much of the contraction in output is due to the fall-off in stockpiling which occurred in the run up to the UK's proposed exit from the EU at the end of March. As firms begin to unwind this preparation, output naturally decreases.

The latest Purchasing Managers Index (PMI) for Northern Ireland indicates that all sectors for the economy were contracting in June of this year. Manufacturing saw new orders fall at the fastest rate since 2012, while the retail and construction sectors reported the lowest levels of business confidence. Pre-Brexit stockpiling was an issue for the manufacturing sector, but Brexit has also played a significant role in the decline of retail as the post-Brexit devaluation of Sterling continues to exert upward pressure on input prices. As Table 1.4 indicates, UK inflation has now fallen below 2 per cent so some of this price pressure may begin to ease in the near term. However, a disorderly exit from the EU is likely to exert further pressure on both producer and consumer prices, either in the form of a further devaluation of Sterling or an increase in interest rates to stabilise the currency.

Examining the results for the first quarter of this year in more detail shows that the Index of Production increased by 1.7 per cent. Most areas of manufacturing either held steady or experienced a small movement up and down, and most of the overall increase in production is due to an increase in textile manufacturing which experienced an unprecedented 22 per cent surge in the first quarter. As this activity was recorded before March 31, it is likely that pre-Brexit stockpiling is present in these figures. If so, we should expect to see an unwinding of this activity in the results for the second quarter.

In contrast, the services sector declined marginally in the first quarter falling by 0.4 per cent in quarter four. While the Information & Communication sector saw the biggest decline (2.2 per cent), Wholesale and Retail - which accounts for the largest share of services sector output - accounted for much of the decline. The construction sector posted a decline of 4 per cent in the final quarter of 2018. There are, as of yet, no data indicating the health of this sector in 2019.

Exports from Northern Ireland grew by 4.4 per cent in the year ending in first quarter 2019. This was higher than the UK (3.5 per cent) but below that of Scotland (12.9 per cent) and Wales (7.5 per cent). The Republic of Ireland remains Northern Ireland's most important export market and sales from north to south increased by 5.5 per cent over the same period.

The Northern Ireland labour market remains strong in the face of increased Brexit uncertainty. The persistence of positive trends in the labour market in Northern Ireland and for the UK as a whole have been somewhat puzzling when compared with output indicators. The rise of low paid employment and activation measures that encourage it may have played some part in this employment boom. We discuss the issue of low pay in Box 1.2. Overall, the unemployment rate in Northern Ireland now stands at a near historic low of 3.1 per cent. In many other economies, this might represent full employment. The unemployment rate in Northern Ireland is lower than that of Germany and all other EU economies with the exception of Czechia, which recorded a rate of 1.9 per cent for the first quarter of 2019. However, the higher than average rate of economic inactivity in Northern Ireland may conceal some remaining slack in the form of discouraged workers.

The claimant count, which measures the take up of out-of-work benefits, is an indicator of the health of the labour market. Up until recently, the claimant count rate was regularly below that of the unemployment rate. The most common explanation of this was that not all people unemployed immediately claim or are entitled to claim benefits and so a small difference between the rates persisted. The most recent results indicate that the claimant count rate (3.2 per cent) is now marginally above the unemployment rate (3.1 per cent). It is likely that the trend of convergence between the two rates indicates a further reduction in labour market slack.

Box 1.2 Low Pay in Northern Ireland

What is Low Pay?

There are a number of different ways to define 'low pay'. The most commonly utilised measure of low pay in the European context defines low wage earners as those who have an hourly wage, which is less than two thirds of the median gross hourly wage. In 2018, two-thirds of the UK median gross hourly wage excluding overtime was £8.49, and so by this measure all workers earning below this level would be classified as low paid. Another method of assessing the extent of low pay is to examine the percentage of workers who earn below what is termed the 'Real Living Wage'. The Living Wage Foundation calculates the Real Living Wage (RLW), which takes account of both increases in the cost of living, and applies to all workers over 18, in recognition that young people face the same living costs as everyone else. The basis of the Real Living Wage is the cost of a basket of household goods and services considered by the public as necessary to obtain a minimum acceptable standard of living with many analysts agreeing that this is a much more robust indicator of low pay. The Living Wage Foundation put the Real Living Wage at £8.75 in 2018 and at £9 in 2019.

Another way in which we can assess the extent of low pay is to examine the percentage of workers who earn at or below the 'National Living Wage'. The 'National Living Wage' was introduced in the 2015 Summer Budget, as the new national minimum wage rate for workers over the age of 25. The introduction of the National Living Wage represented a significant shift in policy in terms of how the legal wage floor was defined and implemented. When implemented the Government set a starting wage of £7.20 and an objective for the National Living Wage to reach 60 per cent of a typical (over-25) worker's hourly wage excluding overtime by 2020. In 2018, the National Living Wage rate was set at £7.83.

How prevalent is low pay and which workers are low paid?

Low-pay is a reality for a significant proportion of workers in Northern Ireland, irrespective of which measure is utilised. In 2018, 28% of employees earn below the Real Living wage; 23% earn below two-thirds of UK median hourly earnings excluding overtime; 10% earn below the National Living Wage - these include those exempted by the structure of the minimum wage including workers aged under 25 years old and apprentices. Some workers are more likely to be low-paid than others are, and concentrations of low paying jobs are found in particular occupations and industries. 75% of workers in the accommodation and food sector were paid below the real living wage, and 40% below the national living wage. Other sectors where there is a particular prevalence of low pay include the wholesale and retail trade sector and the administrative and support service sector. 53% earned below the Real Living Wage and 25% earned below the National Living Wage in the wholesale and retail trade sector. 51% in the administrative and support services sector earned below the Real Living Wage and 25% earned below the National Living Wage. In terms of occupation, those in Sales & Customer service and Elementary occupations are most likely to be low-paid. Some 70% of these workers earned below the Real Living Wage, whilst 30% of workers in Elementary occupations and 20% of workers in Sales & Customer service occupations earned below the National Living Wage. Younger workers, part-time workers, and female workers had a higher likelihood of low pay than other groups. That said, low pay is a particular issue for male workers employed on a part-time basis.

How should policy respond?

Policies directed at increasing the wage levels of those groups of workers who are most likely to be low paid will be particularly beneficial to ensuring that work pays. Legal wage floors do provide one valuable tool for protecting and sustaining the wages of some of the most vulnerable workers. Moreover, serious consideration needs to be given to using collective bargaining agreements and sectoral orders set through a forum for social dialogue as an avenue to ensuring decent pay for all workers.

2 Taxing Property: Some Policy Considerations

2.1 Introduction

This section of the Quarterly Economic Observer (QEO) examines the case for reforms to the taxation of property and wealth stocks in the Republic of Ireland.[1]

The key objectives of any tax system are to raise a meaningful amount of revenue for the exchequer while at the same time minimising administration and compliance costs, reducing inequality, minimising economic distortions, and changing behaviour.

The introduction of the Local Property Tax was a welcome tax reform. Given the strong theoretical arguments in favour of recurrent taxes on immovable property there is a strong case for significantly increasing the basic rate and for rebasing property values to current levels. Proposals to increase the complexity of the tax by applying different rates in different local authorities have little merit. Policymakers should scrap the current equalization system, while hardship issues are best resolved through a deferment system for low-income households.

Net wealth taxes are attractive in distributional terms and taxing wealth and the wealthy can be an important element of social solidarity. However, Ireland should avoid pursuing the type of model that has tended to prevail internationally, i.e. a model with multiple exemptions and reliefs, with a low threshold, and with a high marginal rate. The structure that will best reconcile the tension between our main objectives is one with: A) either zero or very few exemptions and reliefs, B) a relatively high tax-free allowance or threshold, and c) a flat marginal rate that is set at a low level.

Finally, one of the most important fiscal tools for redistributing wealth is Capital Acquisitions Tax (CAT), which is the tax on inheritances and gifts. As it happens, the generosity of exemptions and reliefs on business and agricultural property, combined with the highest tax-free threshold, makes it possible in some cases to inherit over €3 million without attracting any CAT liability. This clearly undermines horizontal equity between taxpayers and enables the tax-free transfer of substantial amounts of assets across generations. Policymakers should significantly scale back the value of these reliefs.

[1] This section of the QEO including all references are from the paper: *McDonnell, T, 2019. Taxing Property: Some Policy Considerations, NERI Working Paper No. 63, July 2019*.

2.2 Revenue Comparisons and capital taxation

The potential tax base is comprised of that which we can tax. Tax policy should not just be about the advantages and disadvantages of any individual tax. It should consider the overall tax package including its composition and the aggregate size of the tax take relative to that of the overall economy. Governments obtain all of their tax receipts (including social security contributions) from one or more of three tax bases – consumption, labour, and capital.

Ireland's bespoke indicator of output called Modified gross national income or GNI*, is likely to underestimate Ireland's fiscal capacity in relation to capital taxation. As an alternative to GDP or GNI*, Goldrick-Kelly and McDonnell (2017) examined tax revenues in different countries according to contributions per capita. Specifically, they compare per capita receipts from taxes and social contributions in the 11 European Union (EU) 'peer' countries with GDP per capita in excess of €30,000 and find that Ireland had the lowest total receipts of all 11 countries.

They find that per capita taxes on capital in 2015 were €3,129 in Ireland, and a population-weighted €3,150 in the 10 peer countries. That amounts to a difference of less than 1 per cent. However, once they excluded corporate tax receipts they found that that per capita tax receipts on capital fell to €1,630 in Ireland versus €2,187 in the peer countries. The difference in receipts of €557 amounted to €2.6 billion scaled over the population. Fully half of the difference was attributable to lower receipts from capital stocks (i.e. wealth).[2]

In output terms in 2016, recurrent taxes on immovable property were 0.9 per cent of Irish GNI* and 1.6 per cent of the EU's GDP. This amounts to a gap of €1.2 billion. Ireland was also relatively low in terms of its receipts from other taxes on property, at 0.8 per cent of GNI* versus 1.0 per cent of the EU's GDP, a gap of close €350 million. Overall, in relative economic output terms Ireland collects over €1.5 billion less than the EU in receipts from various property taxes in 2016 (1.7 per cent of Irish GNI* compared to 2.6 per cent of the EU's GDP).

[2] Goldrick-Kelly (2019) estimates that relative to the peer country population-weighted average, lower receipts in Ireland from capital stocks amounted to €323 per capita in 2017, or €1.54 billion when scaled over the population.

Table 2.1 Capital Taxation, Ireland (% GNI*) and EU, (% GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total capital revenue										
Ireland	11.0	8.7	7.7	7.7	7.8	8.3	8.0	8.3	9.4	8.9
European Union	9.0	8.5	7.6	7.5	7.7	8.0	8.1	8.2	8.4	8.4
Immovable property (recurrent)										
Ireland	0.7	0.8	1.0	1.0	1.1	1.1	1.3	1.3	1.1	0.9
European Union	1.2	1.2	1.2	1.4	1.4	1.6	1.6	1.6	1.6	1.6
Other										
Ireland	2.2	1.3	0.9	0.8	1.1	1.2	1.0	1.3	1.0	0.8
European Union	1.1	1.1	0.8	0.8	0.9	0.8	0.9	0.9	1.0	1.0

Sources: Eurostat (2018), CSO (2018), NERI calculations

2.3 Tax expenditures

It is worth considering the significance of tax expenditures for our key objectives of equity (horizontal[3] and vertical[4]), economic efficiency, and simplicity. Tax expenditures are a type of non-transparent public spending that benefits particular interest groups by treating certain activities or groups in a preferential way. The main distinction with public spending is that the preferential treatment for the recipient group comes in the form of reduced taxes instead of in the form of direct subsidies or other spending by a government department.

Public spending in the form of tax expenditures tends to deliver larger benefits to higher income households. Many reliefs allow a tax deduction at the individual's marginal rate of income tax. Such reliefs disproportionately benefit those with the highest income tax rates and undermine the principles of horizontal and vertical equity. The impact of these types of tax relief is to reduce the progressivity and equity of the tax system and to do so in a way that is less transparent than direct public spending.

The standard rationale for tax expenditures is to encourage a particular economic activity. However, there is often a deadweight loss associated with tax expenditures to the extent they subsidise economic activity that would have happened anyway in the absence of the tax break.

[3] Horizontal equity is the idea that we should treat persons or groups with the same taxable capacity, or ability to pay, equally, and that they should pay the same amount of tax. Exemptions, reliefs, or favourable valuations or rates all undermine horizontal equity.

[4] Vertical equity is synonymous with the principle of progressive taxation – i.e. that those with greater taxable capacity should bear a proportionally heavier tax burden.

Tax expenditures change the incentive structure for households and firms and therefore influence the behaviour of households and firms. The behavioural changes induced can have positive and negative impacts on both short-run and long-run economic growth and also on overall societal wellbeing.

In general, tax expenditures will negatively affect growth by distorting allocative efficiency, by creating inefficiencies in production and consumption, and by diverting economic activity toward rent-seeking behaviour. On the other hand, well targeted tax breaks can have positive impacts over the long-term to the extent they reduce negative externalities such as pollution, and also to the extent they encourage activities such as basic research that generate positive externalities.

2.4 Residential property tax

Residential property is a major component of wealth and the introduction in Ireland of the Local Property Tax (LPT) in 2013 was a positive and necessary tax reform. Almost all advanced economies have some recurrent tax on immovable property. The economics literature generally finds that taxes on immovable property and taxes on land are the least distorting to economic activity and the least damaging to economic growth. These taxes are also very difficult for the super-wealthy to avoid because the underlying asset lacks mobility and is impossible to hide. The OECD (2010) looked at the impacts of various taxes from an economic efficiency perspective and found that recurrent taxes on immovable property are the least damaging (i.e. most beneficial) to long-run per capita GDP growth prospects.

There are strong theoretical arguments in favour of recurrent taxes on immovable property (the LPT in the Irish case):

a. LPTs have been shown empirically to have a minimal negative impact on GDP; in other words it is a growth-friendly tax;

b. LPTs are very difficult to avoid or evade;

c. Unlike transaction-based property taxes LPTs are reasonably stable throughout the economic cycle and therefore provide a reliable tax base;

d. LPTs do not by and large penalise productive activity;

e. Taxes on immovable assets are particularly appropriate in the context of increasing globalisation where the factors of production are increasingly mobile;

f. LPTs do not create a barrier to labour mobility (unlike transaction based property taxes);

g. LPTs can encourage investors to redirect capital to more productive sectors of the economy;

h. LPTs can be progressive if correctly designed and

i. LPTs enable the State to recoup some of the costs of public infrastructure provision through the increased (and unearned) value that will accrue to local housing.

As property taxes are taxes on the ownership of property, they will disproportionately fall on wealthier households. Nonetheless, the strongest counterargument is the potential to cause economic hardship in some cases. This is of course a concern common to almost all forms of taxation – not just LPTs – and does not invalidate the many arguments in favour of property taxes. The hardship argument is best resolved through a deferment system for low-income households. Such a system is already in place in Ireland with interest charged on the deferred amount. The deferred amount along with the accumulated interest is payable on the sale or transfer of the property. This resolves the hardship problem while simultaneously protecting government revenue over the long-term.

There is also an argument that the family home is not wealth. However, this ignores the fact that the principal residence is a capital asset that the owner can buy or sell and that accounts for significant inter-generational wealth transfer. Over the long term, people who rent often pay as much, if not more, on annual housing costs as people who purchase housing, but only the homeowner ends up with a valuable asset.

To ensure horizontal equity between households, the tax must be a fixed proportion of property value. In other words, two taxpayers with properties worth €250,000 should pay the same amount of property tax regardless of geographic or other factors. A deferment does not break this principle as it merely changes the timing of the payment.

Much of a property's value and the benefits accruing to its owner derives from the property's location including its proximity to infrastructure (e.g. rail and roads), as well as other public services (e.g. schools and hospitals) paid for or subsidised out of general taxation. Local authority revenue excluding grants from central government is a small fraction of total general government revenue. In this context, the argument for allowing significant local deviations from a nationally set property tax rate is limited.

The principle of vertical equity could justify a progressive structure involving higher tax rates on more valuable properties. On the other hand, too many rates might lead to an overly complicated structure and violate the principles of simplicity and transparency. Too many rates would also increase the sensitivity of the LPT yield to property price fluctuations.

The Irish LPT has twenty valuation bands. The lowest is from €0-100,000, the second to nineteenth valuation bands are each €50,000, and the highest valuation band is for properties over €1 million. A standard tax rate of 0.18 per cent applies to the mid-point of the band to calculate the tax liability. Properties valued over €1 million are chargeable on actual market value at a higher rate of 0.25 per cent. As such, the basic system adheres to the principle of horizontal equity, and with the higher rate, incorporates an element of vertical equity.

Local authorities have the flexibility to vary the rate up or down to a maximum of 15 per cent. In practice, nine of the thirty-one local authorities applied a locally adjusted rate in 2019. As such, households with the same value property in different local authority areas experience different liabilities. This violates the principle of horizontal equity. A further complication is that 20 per cent of the yield in each local authority goes to an equalisation fund, meaning that in some cases not all the benefit of the LPT revenue goes to the local authority area. Given that central government grants and subsidies comprise a substantial proportion of local authority funding, it is unclear why an equalisation fund needs to exist at all.

Recurrent taxes on immovable property (known as RP taxes) are generally more growth-friendly than other taxes and this in turn suggests that a greater reliance on these types of taxes will be growth enhancing. Ireland got just 2.6 per cent of its aggregate tax revenue from this type of tax in 2017, whereas the average for the EU was 4.0 per cent. Irish revenue from RP taxes was 1.0 per cent of GNI* in 2017, while EU revenue from RP taxes was 1.6 per cent of GDP.

Ostensibly, there therefore appears significant scope to shift the composition of revenue away from other forms of taxation in order to improve Ireland's growth potential, or alternatively, to increase RP taxes to fund increases in public spending. Table 2.2 shows that commercial rates accounted for 71.7 per cent of RP taxes in 2017 compared to just 28.3 per cent for taxes on residential property. This suggests that most of the potential scope for increase is in relation to the LPT.

Table 2.2 Recurrent taxes on immovable property, 2017, € millions

Total revenue	1,775
Commercial Rates	1,273
Local Property Tax	477
Non Principal Private Residence Charge	25

Source: Eurostat (2019)

Recurrent taxes on immovable property would have needed to be €2.9 billion in 2017 in order to reach the EU average as measured by proportion of economic output. An indicative 50-50 split in the yield between commercial rates and taxes on residential property (i.e., €1.45 billion from each tax) would imply just under an additional €1 billion needed from taxes on residential property, or close to a trebling of the current yield. The Interdepartmental group review (2019) of the LPT estimates the annual yield in Ireland rebased at November 2019 values and including some previously exempt properties, with no local increases or reductions, and applied at the central rate of 0.18 per cent, would yield €771 million. That implies the rate would need to almost double to bring the Irish yield in line with EU averages.

There is a strong efficiency and equity case for increasing the yield as a proportion of output. In practice, this means increasing the rate. However, political economy realities mean this would probably need to happen gradually over a multi-year period. An increase of 0.01 per cent per annum would imply an annual increase of €27.50 (€0.53 cent per week) for the median property rebased at November 2019 values.

The Interdepartmental group (2019) considered a number of scenarios for achieving a broad yield of €500 million per annum. However, only two of these scenarios (Scenario 1 and Scenario 5) are consistent with the principles of horizontal equity and simplicity. The group's Scenario 1 applies an indicative central rate to all properties. They estimate a rate of 0.114 per cent generates a €500 million yield. This would lead to a higher charge for some properties and a lower charge for other properties compared to the current LPT structure. Scenario 5 broadens the bands from €50,000 to €90,000. The intent here is to ensure that the liability associated with each valuation band remains unchanged. As it happens, neither Scenario would significantly increase the yield. Our view is that either of these two scenarios combined with a commitment to increase the rate by 0.01 per cent or 0.02 per cent annually over a ten-year period would constitute a welcome reform.

2.5 Net wealth tax

Wealth is a function of past endowments (mainly inheritance), past income flows, past value changes, as well as past saving and consumption decisions. Ireland has not had a recurrent (e.g., annual) tax on net wealth since it abandoned the tax in 1978. The 2009 Report of the Commission on Taxation cited concerns about potential capital flight in an environment where capital is highly mobile as well as concerns about high administration and compliance costs. Arguments in favour of a wealth tax range from the potential revenue yield, to social justice considerations, to potential economic benefits, and to administrative advantages such as assisting the fight against tax evasion. The taxation of wealth raises wider issues about the potentially harmful effects of wealth concentration e.g. through its effects on the balance of power and influence in a country and society.

A good wealth tax may have some limited exemptions. However, the scale and range of the exemptions and reliefs that developed over time in different jurisdictions increasingly undermined the justification for wealth taxes on horizontal equity grounds; as well as increasing the administrative burden; encouraging the use of tax planning by the very wealthy to avail of tax shelters, and reducing the overall tax yield. McDonnell (2013) extensively discusses the principles of wealth tax design in depth and cautioned that if Ireland were to introduce an annual wealth tax it should avoid pursuing the type of wealth tax model that has tended to prevail internationally i.e. a model with multiple exemptions and reliefs, with a low threshold, and with a high marginal rate.

The need for regular valuations imposes compliance and administration costs. Valuation issues are a key barrier to introducing a wealth tax. There are three main objectives when choosing the best valuation method: A) obtaining accurate values, B) minimising administration and compliance costs, and C) minimising uncertainty and delay. Tension between these goals is inevitable and compromise and approximation in valuation are necessary. Valuation is particularly difficult where there is no active market for the asset type in question. Assets like goodwill and human capital may be impossible to value in practice. Valuing pension rights also represents particular difficulties.

To reduce the administration, compliance and uncertainty costs of running the tax we can apply a number of general rules:

1. Self-assessment should be used wherever possible;
2. A single rate is preferable to a graduated rate;
3. A high threshold of liability should apply;
4. An exemption can be given for personal and household effects worth up to a certain value;
5. Uniform rules and formulae should be set for the valuation of particular asset classes. These rules should be as simple, easily understood, and transparent as possible;
6. Rules and formulae should err on the side of undervaluation in order to obtain political acceptance and in order to minimise legal challenges;
7. The value of the taxpayer's total net wealth could be treated as fixed for a number of years e.g. for three years, before being re-assessed;
8. Alternatively, the value of particular asset classes can be treated as fixed for a number of years e.g. business assets, land or real estate;
9. Statutory provisions can be adopted to automatically adjust the thresholds and allowances every number of years to account for inflation;
10. Trusts could be treated as automatically transparent or 'see-through' in the sense that the trustee is legally obligated to identify the beneficiary or beneficiaries to the tax authorities with the value of the fund then added on a proportional basis to the assessable gross wealth of the beneficiaries.

Setting a low threshold of liability for a wealth tax will increase the number of households that are liable. However, a low threshold of liability will also increase the administrative burden as well as political opposition to the tax. A high marginal rate will increase the yield but might undermine the rationale for accumulating savings and for investing. McDonnell (2013) provides an in-depth discussion regarding the advantages and disadvantages of including exemptions and reliefs for different types of assets and recommends minimal exemptions and reliefs.

While broadly in agreement, the OECD (2018) make a case on economic grounds for providing relief for business assets. Overall, the structure that will best reconcile the tension between our main objectives will have:

a) Either zero or very few exemptions and reliefs;

b) A relatively high tax-free allowance or threshold;

and

c) A flat marginal rate that is set at a low level.

For practical reasons a net wealth tax should contain an exemption for human capital, as well as for the insured value of personal property up to a modest amount. There is also a reasonable case for partial or full exemption of pension rights, for 'goodwill', and for heritage goods and collections.

Lawless and Lynch (2016) used micro-data from the CSO's Household Finance and Consumption Survey 2013 (CSO, 2015) to make estimates of wealth tax revenue for nine separate scenarios of wealth tax design. Six of their nine scenarios had major exemptions for particular asset types. Such a design approach is highly problematic, as it would distort investment decisions and create tax shelters. Of the remaining three scenarios described, one allows for no personal threshold. Such a scenario would impose compliance costs on the entire population of households along with creating significant administration costs. In addition, the equity goals underpinning the wealth tax imply the need to tax 'excessive wealth disparities' rather than 'all wealth'. This design approach, while yielding the most revenue for the exchequer, would not be desirable or feasible.

The remaining two scenarios provide for generous thresholds and a 1 per cent rate. Lawless and Lynch find that a scenario with a €1 million personal threshold (doubled if married) and an additional €250,000 per child would have generated €248 million in 2013 and affected just 1.5 per cent of households. An alternative scenario with a €500,000 personal threshold (doubled if married) and an additional €125,000 per child would have generated €622 million in 2013 and affected 6 per cent of households. A notable concern with these scenarios is that the doubling of the threshold in the case of marriage appears excessively generous.

We can choose to impose a maximum income cap (ceiling relief) in order to assuage affordability concerns that might arise for high wealth but low-income households. In reality, the taxpayer will almost invariably pay the wealth tax out of income so that it effectively acts as a surtax on income tax. Lawless and Lynch estimate that introducing a 33 per cent income cap at the 1 per cent rate would have reduced the yields to €182 million and €508 million respectively in 2013.

Net household wealth as measured by the Central Bank's Quarterly Financial Accounts (2018) increased by close to two thirds between 2013 and 2017. This means that the two 'high threshold and no exemption' scenarios would have generated significantly more tax revenue in 2017 than in 2013, albeit with a larger proportion of households affected. However, we cannot be precise about likely yields in 2017, due to the absence of more-up-to-date wealth distribution statistics.

2.6 Capital Acquisitions Tax

While the holding of net wealth is currently untaxed in Ireland, there are other taxes on wealth. Capital Acquisitions Tax (CAT) is a tax on wealth transfers and Capital Gains Tax (CGT) is a tax on the appreciation of an asset's value. Sandford (1987) argues that inheritances and other endowments explain a large proportion of wealth inequality. CAT includes inheritance tax, gift tax and Discretionary Trust tax. CAT was introduced in 1976 as a partial replacement for estate duty and is charged on the amount gifted to, or inherited by, the person (known as the donee) receiving the gift/inheritance. The rate has been 33 per cent since December 2012. Net CAT receipts were €522 million in 2018 and €460 million in 2017 most of which came from inheritances.

CAT has a tax-free threshold known as a group threshold, which is determined based on the relationship between the person making the gift or leaving the inheritance (known as the disponer) and the donee. The tax-free thresholds often change to reflect inflation. The threshold is €320,000 for a child, €32,500 for a sibling, niece, nephew or lineal ancestor or descendent, and €16,500 for all other groups. The different thresholds for different groups are extremely difficult if not impossible to justify on equity grounds.

CAT also has a number of generous exemptions and reliefs. There is an exemption on the first €3,000 of taxable gifts received during each tax year, and very significantly, there is an exemption for gifts and inheritances made between spouses/civil partners. There are also highly generous agricultural and business property reliefs, which reduce liability to CAT by 90 per cent. The relief operates by reducing the market value of the relevant assets by 90 per cent, so that CAT is calculated on an amount - known as the 'agricultural value' or 'business value' as appropriate - which is substantially less than the market value. There is no upper ceiling on these reliefs.

One defence of business and agricultural property reliefs is that they might prevent businesses splitting up (Boadway et al., 2010). However, evidence from Bloom (2006) suggests that the retention of medium-size businesses might actually harm the efficiency of the economy through inferior management practices. To deal with liquidity issues Boadway et al. (2010) offers the possibility of businesses and farms claiming instalment relief, which could enable tax payment over multiple years at a very low interest rate.

The exemptions for certain gifts and the range of various reliefs and loopholes currently enables the very wealthy to minimise their CAT liability. This suggests a need for meaningful reform. The generosity of these exemptions and reliefs clearly undermine the principle of horizontal equity between taxpayers and greatly deplete the potential yield. In particular, there should be a review of the exemption for spouses. If spouses are brought within the charge then a high threshold should be set to ensure forced sales of family homes does not become an issue. A threshold of between €1,000,000 and €1,500,000 might be an appropriate threshold for transfers between spouses. In addition, while recognising the rationale underlying agricultural and business reliefs, the 90 per cent reduction is overly generous. The absence of a ceiling on these reliefs is very difficult to justify on horizontal equity grounds.

2.7 Other reforms

Ireland partially[5] taxes capital appreciation through Capital Gains Tax (CGT). We charge CGT on the value of the capital gain made on the disposal of an asset. CGT is 33 per cent. There are a number of CGT reliefs and an annual exemption of €1,270 for all assets disposed of by an individual. The OECD (2011) suggests that a prudent reform for its member states would be to align the tax rates that apply to income and capital gains more closely. They argue that differences in tax rates on different types of income (e.g. interest compared with capital gains) are at the heart of much income-shifting tax planning and more aggressive avoidance opportunities. The logical destination for this argument is to treat capital gains as income for tax purposes. The OECD (2011) also argues that trusts should not benefit from concessionary rates.

Stamp duty applies ad valorem on residential and non-residential property transactions. Rates vary from 1 per cent and 2 per cent on residential property to 6 per cent on non-residential property. Stamp duty also applies at a rate of 1 per cent to transfers in stocks and shares by way

[5] Many asset classes are not covered and there are exemption e.g. for the principal private residence.

of sale. There is also a levy at the rate of 3 per cent on premiums received by insurance companies from certain classes of non-life insurance business and a range of other minor levies. Net receipts from stamp duties were €3.6 billion in 2006 and €3.2 billion in 2007. However, this had fallen to €1 billion by 2009 and it was €1.5 billion in 2018.

The decline reflects falling yields from charges on land and property and from charges on stocks and shares. Stamp duty receipts tend to be volatile and are often sharply pro-cyclical. Stamp duty also discourages capital transactions and acts as a barrier to economic efficiency. One revenue neutral but potentially growth enhancing option is to shift the composition of capital taxation away from stamp duty and towards another form of capital taxation, for example, a stronger local property tax, a net wealth tax, or a land tax.

Nevin Economic Research Institute (NERI)

31/32 Parnell Square
Dublin 1
Phone + 353 1 8897722

45-47 Donegall Street
Belfast
BT1 2FG
Northern Ireland
Phone +44 28 902 46214

Email: info@NERInstitute.net
Web: www.NERInstitute.net