Irish Congress of Trade Unions

Pre-Budget Submission

A different fiscal adjustment is possible

Autumn 2013

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Irish Congress of Trade Unions

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A change of course is required if there is to be any hope of economic recovery.

Summary

Ireland is in its sixth year of stagnation. A change of course is required if there is to be any hope of economic recovery. Economic policy must become more job focused and growth friendly. We can adopt this approach and still reach agreed budgetary targets. In reality we stand a better chance of reaching those targets if we combine a different fiscal adjustment with an investment/jobs stimulus.

There are three key measures that could be adopted in the forthcoming budget to make this happen:

(i) use the proceeds of the 'Promissory Note' deal to reduce the size of the budget adjustment;

(ii) bring forward a capital investment stimulus package of €4.5 billion over the next two years; and

(iii) target tax increases at the richest 10% of households.

We believe this will result in the creation of new jobs, boost economic output and government revenue and avoid further damage to essential public services and social cohesion.

Focusing on growth would also help to restore international confidence in Ireland, while addressing infrastructural deficits that undermine our competitiveness.

This policy mix would result in a reduction in the government deficit to about 3% of GDP in 2015.

Current policy has left us with one in four out of work or under-employed, with collapsed retail sales and flat domestic demand and with public finances constrained by the cost of servicing the private banking debt.

Current Economic Outlook

Recovery in output and employment is likely to be very slow over the coming two years as continued austerity and high levels of private debt combine to suppress domestic demand.

Government ambitions to reach the deficit target of 3% by 2015 depend on a range of circumstances, some of which are outside domestic control. The government plans two further 'austerity' budgets in 2014 and 2015.

Here, we set out an alternative approach to reducing the deficit through an investment stimulus, tax increases for high-income households and no further cuts in the overall level of non-pay spending for public services.

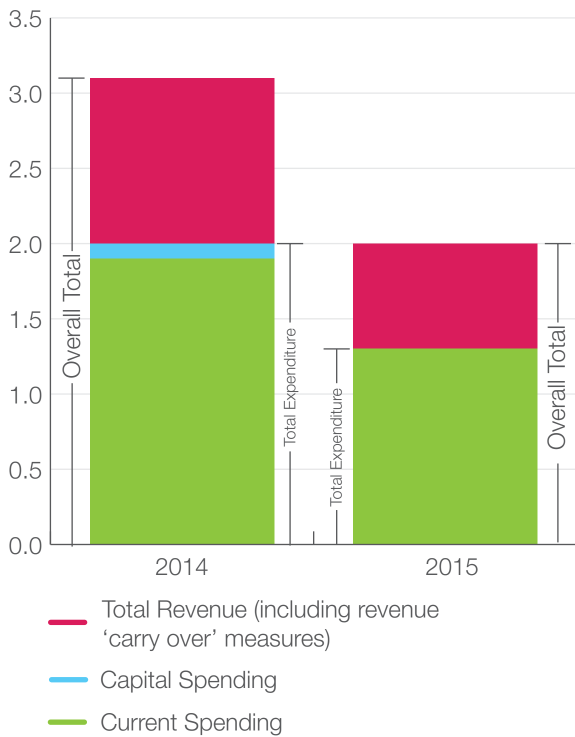
The Deficit

The total government deficit has fallen from 13.9% of GDP in 2009 to a projected 7.5% in 2013. However, when 'like with like' is compared by removing the impact of banking, it is clear that the fall is somewhat less – down from 11.5% in 2009 to 6.9% in 2013 – most of which goes to service debt (4.9% of GDP). The deficit includes a rising proportion spent to service government debt which was greatly inflated as a result of monies transferred to the banks. The bank debt deal announced on February 7th 2013 provides the government with some room for manoeuvre and for policies to generate additional investment and employment.

The Current Plan

Figure 1 summarises planned budgetary measures in 2014 and 2015. It includes a substantial adjustment to both pay and non-pay expenditure over the coming two budgets.

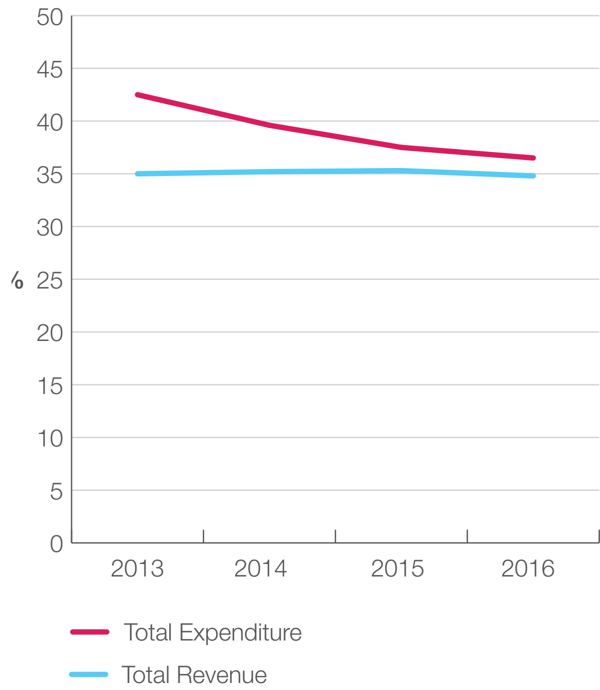
Figure 1. Planned fiscal consolidation effort in 2014-2015 (€ billion)



Source: Department of Finance 2013.

Under current plans, it is projected that public spending will fall from 42.5% of GDP in 2013, to 36.5% in 2016 while government revenue is set to remain at its current estimated level of 35% of GDP (Figure 2).

Figure 2. Projected general government revenue and expenditure (% GDP)

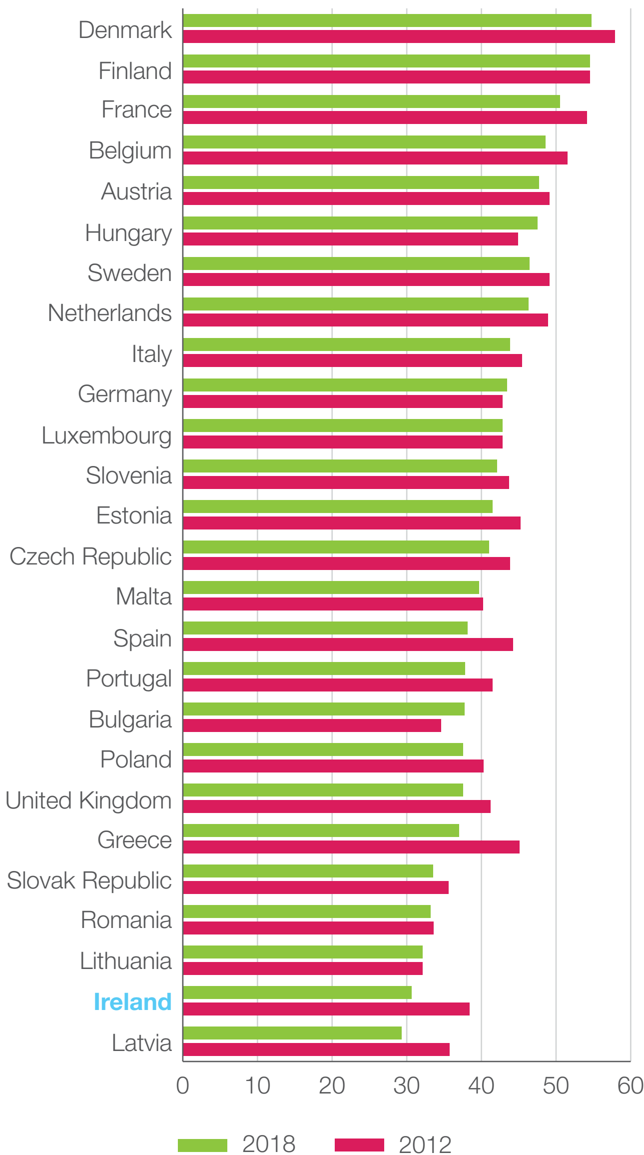


Source: Irish Stability Programme Update. Page 50. Table A1 (Department of Finance, 2013).

Part of what is termed public spending actually goes towards interest payments on government debt, while the remaining spending is referred to as 'primary spending'. If the government continues with planned cuts to public spending, Ireland will have the second lowest level of 'primary' public spending of 26 European member states, in 2018 (Figure 3). In other words, only one country in the entire European Union (Latvia) will spend less on their public services than Ireland, by 2018.

Economic history suggests that the fastest way to reduce the deficit is through policies that promote growth and jobs.

Figure 3. Projected public spending (less interest payments) (% GDP)



An Alternative Approach

Globally, there is clear evidence that austerity has been damaging in many countries. According to an IMF staff paper:

> *"The analysis in this paper shows that withdrawing fiscal stimuli too quickly in economies where output is already contracting can prolong their recessions without generating the expected fiscal saving. This is particularly true if the consolidation is centred around cuts to public expenditure—likely reflecting the fact that reductions in public spending have powerful effects on the consumption of financially-constrained agents in the economy —and if the size of the consolidation is large. Large consolidations make recessions more likely even when made at an expansion time."*
> *(Batini, Callegari and Melina, 2012)*

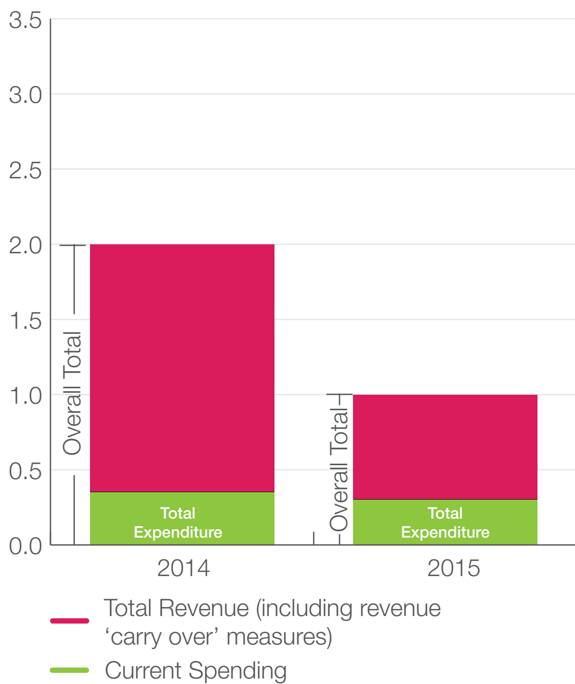
Economic history - including our experience of the 1980s - suggests that the fastest way to reduce the deficit is through policies that promote growth and jobs.

Measures to cut spending and raise taxes can help, but the impact will vary depending on the measures adopted, as research carried out this year by the Nevin Economic Research Institute (NERI) indicates. The research shows that cuts in many areas of public spending are less effective than increases in taxation in reducing the government deficit. We are proposing an alternative approach, as follows:

- A smaller overall budget adjustment in 2014 and in 2015;
- an investment stimulus of €4.5 billion to the end of 2015; and
- higher taxes targeted at the highest earning households, along with a contribution from the corporate sector.

This would raise levels of employment and output more than under current fiscal plans.

Figure 4. An alternative fiscal consolidation effort in 2014-2015 (€ billion) combined with a €4.5 bn investment stimulus



Overall, there are four key elements to the alternative approach proposed by Congress:

i. A smaller fiscal consolidation in 2014 and in 2015, taking advantage of the Promissory Note deal;
ii. No further cuts to non-pay 'primary' public spending and greater efficiency in the delivery of public services;
iii. Tax measures targeted at high-income households;
iv. An investment stimulus, funded commercially, that draws on public, private and European investment sources.

It is important to acknowledge that the measures arising from the Haddington Road Agreement, which involve approximately €1 billion in fiscal effort to reduce the public sector pay bill, has been included in the overall budgetary adjustment proposed by Congress. Any additional measures to increase taxes on the highest-income households would be offset by no further cuts in non-pay public services from which all citizens benefit to a greater or lesser extent, including the highest earners.

I Smaller Fiscal Consolidation in 2014 and in 2015 through Allocation of €1 billion from the 'Promissory Note' Deal

It is estimated that, on foot of the Promissory Note deal, the total reduction in the cost of interest payments on government debt will be in the region of €1 billion in both 2014 and 2015. While the government deficit has declined modestly over the last four years (from an underlying rate of 11.5% of GDP in 2009 to an estimated 6.9% in 2013 when the impact of banking transfers and receipts are excluded), the amount of money taxpayers are spending to service government debt has risen sharply as a proportion of GDP and now accounts for most of the deficit. Relief in regard to the public cost of servicing private debt that was socialised must remain an important component of any effort to separate sovereign and banking related debt.

II Preservation of Existing Levels of 'Primary Spending'

It is important that the quality and volume of public services should not be further eroded through additional cuts, particularly in the 'non-pay' area of public spending. These include social transfers such as social welfare and student maintenance support, purchase

There is evidence that tax rises have a bigger impact on deficit reduction than spending cuts.

of materials from the private sector and capital investment (expenditure on equipment, buildings and maintenance).

Areas of waste, duplication and under-performance in the public sector need to be addressed. In keeping with recent public service agreements, public procurement needs to be constantly reviewed to ensure the taxpayer is obtaining the best value for money. Where savings are made the money should be re-directed to improving critical areas of public service delivery that have suffered in recent years. These could include, for example:

- Early childhood education and care;
- Mental health and disability services;
- Youth Guarantee/apprenticeship training;
- Primary health care in the community.

The introduction of a social inclusion provision in regards to the installation of water meters is a welcome development.

In addition, Congress urges that government should not cut back further on overseas development aid spending and move toward the UN spending target of 0.7% of Gross National Income.

III Targeting High Earners

The total revenue received by government from taxes and all other sources is estimated to be 35.2% of GDP in 2013. It is projected to fall in 2015 and in 2016.

This is unacceptable while there is still a large gap between what we spend and what we take in. There is also evidence that tax rises have a bigger impact on deficit reduction than spending cuts.

We cannot continue to provide decent public services on this basis. Widening the tax base is crucial in this regard. There is a strong case to begin tax reform 'at the top' by tackling the low level of average 'effective' tax paid by many high-income households. Marginal rates are in the 52-55% range for many taxpayers. It is not proposed to increase these rates. However, it is possible to increase, modestly, the average rate of tax paid by the highest-income households (those in the top 10%).

Based on research by NERI, Table 1 provides a summary of possible tax measures that could be introduced as an alternative to cuts in non-pay current spending.

Table 1. Proposed additional tax measure in Budgets 2014 and 2015 (€ billion)

	2014	2015
Revenue 'carry-over' from previous year's budget	600	100
Changes to income tax reliefs for the top 10% of households (e.g. pensions)	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
TOTALS	**1,650**	**700**

Possible New Tax Measures

Income taxes

Ireland stands out from other European countries in at least two important respects:

- Employer social security contributions are relatively low (3.5% of GDP in 2011 compared to an EU27 average of 6.4%);
- Average effective tax rates are low.

There is a case for raising the effective income tax rate on income groups above the poverty level. However, this needs to be planned and timed carefully, taking account of various factors, including the relatively unequal distribution of income and impact on domestic demand.

Based on estimates from the CSO EU-Survey of Income and Living Conditions (SILC) data it is estimated that households in the top 10% of all households had gross income in excess of €109,000 per annum in 2011. In this case, gross income refers to all income received by all persons in a household including social welfare, earnings from employment, dividends, rent and royalties. The top 10% paid an estimated €6.8 billion in income tax, Universal Social Charge and Pay-Related Social Insurance. This corresponds to just 25.6% of their total gross income of €26.4 billion.

The average rates of tax paid by high-income households could be increased in a progressive manner without altering the headline income tax, USC or employee PRSI rates through:

- introduction of a minimum effective rate payable in each case;
- reduction in the level of tax reliefs of those in the top income decile[1];
- gradual withdrawal of tax credits above a threshold of €109,000 per annum.

It would be possible for government to raise €600 million in income tax over two years by targeting revenue increases on the top 5% or 10% of households.

Corporation Taxes

Corporations have made very little additional contribution to fiscal adjustment since 2008. There is a strong case for setting a minimum effective tax rate for all corporations to boost revenue from corporations. This could be achieved *without* necessarily changing the headline rate of 12.5%. In the light of recent revelations of corporate tax avoidance it is important that companies pay a greater contribution.

Some €250 million in additional revenue could be raised in 2014 by targeting existing reliefs and provisions for carry-over of corporate losses. This would represent an increase in the effective rate by a fraction of one percentage point and is unlikely to deter existing or future foreign direct investment.

1 This would apply to the highest income deciles only. Congress does not endorse an income tax standardisation of pension relief given the absence of a coherent and comprehensive pension provision for the population as a whole.

Some €250 million in additional revenue could be raised in 2014 by targeting existing reliefs and provisions for carry-over of corporate losses.

In the event of a very large oil, gas or mineral find, these resources - owned by the people of Ireland – are likely to be under-taxed. What is taxed today is only the profits on the business of extraction. All developmental losses from other exploration costs can be offset against these taxable profits, reducing them dramatically, sometimes to zero. A 12.5% oil and gas royalty tax on production above a threshold should be reintroduced. This would be in addition to Corporation Tax provision.

Losses, Reserves and Interest Relief

Government should reform how companies can manage corporate losses and minimise their tax bill. Such practices are of dubious economic benefit and often transfer risks from business to the exchequer.

Wealth Tax

A wealth tax could yield well over €150 million for the exchequer while minimising distortions to economic activity (McDonnell, 2013, forthcoming). A wealth tax with highly restricted exemptions and reliefs can also be a valuable tool for clamping down on tax evasion by revealing potential sources of income which might otherwise go undeclared.

IV A Smart Investment Stimulus

The case for an investment stimulus has been outlined by Congress (2012), NERI (2012) and Duggan (2013) among others. In short, our competitiveness will suffer if we continue to under invest in key infrastructure and skills over the remainder of this decade. An investment stimulus would:

- address some of the key economic and social deficits, including childcare provision, insulation of buildings, generation of new forms of energy, upgrading of broadband, improved transport etc;
- create jobs, boost government revenue and enhance our competitiveness.

We propose an investment stimulus of €4.5 billion over two years. It is vital projects are carefully selected on the basis of a rigorous cost-benefit analysis with maximum local employment impact. This will take time and, in any case, might entail a lead-in period of 12 months or more depending on the stage of development in terms of funding or planning approval any particular proposal is at. An immediate start could be made in regard to particular projects of high social benefit and which are almost ‘ready-to-go’ in terms of planning permission, funding and assessed need.

Such a stimulus could be financed in a number of ways that would limit the cost to the taxpayer (see NERI, 2012).

An 'off-the-books' investment stimulus corresponds to an additional investment in the economy financed and operated so as not to add to the government deficit, in line with Eurostat rules and in keeping with the Excessive Deficit Procedure used to monitor government deficit in EU States.

The recent decision by government to use over €6 billion from the National Pension Reserve Fund as investment in infrastructure is very welcome. It needs to be brought forward quickly.

Conclusion

There are a number of risks associated with the government's current austerity programme:

- Continued high unemployment.
- The 'scarring' impact of youth unemployment.
- Significant under-investment in key economic and social infrastructure
- Further contractions in the quality of public services

There is an urgent need to use fiscal policy to protect the vulnerable, particularly the long-term unemployed through income support and training. In addition, we need to stimulate growth and job creation through a mix of policies focussing especially on investment in key infrastructure. We need job-friendly, growth-friendly and equality-friendly policies.

Adopting the alternative approach outlined above would have a positive impact, compared to current government plans.

We believe it would result in the creation of over 40,000 new jobs, while the deficit would be lower by approximately 0.3 percentage points in 2013.

Consistency, seriousness and demonstrable progress are central to rebuilding trust and confidence over time. A key challenge is to address the very present danger of prolonged stagnation with high and socially unsustainable levels of unemployment.

Table 2. Estimated Net Differences in 2014 and 2015 – Output, Employment and Public Finances

	2014		2015	
	Current plan versus 'do nothing'	Alternative plan versus current plan	Current plan versus 'do nothing'	Alternative plan versus current plan
GDP (% point difference)	-1.4	+2.3	-1.0	+1.8
Employment	-22,000	+41,000	-39,000	+75,000
Government Deficit (% point difference)	-0.7	-0.3	-1.2	-0.8

Source: NERI macro-economic estimates.
Notes: A 'do nothing' benchmark was estimated on the basis of no discretionary fiscal adjustments in budget 2014 or 2015.
The current fiscal plan is as outlined in Figure 1.
The alternative fiscal plan is as outlined in Figure 4.

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