

Tax Cuts did not create the Celtic Tiger

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CONTENTS

Executive Summary	2
Averages Disguise Much Unfairness	2
Some Reform, Some Progress	3
Spending Taxes	5
Taxes are for Little People	5
Rewarding Effort & Enterprise	7
There were Cuts in Tax Rates & Income Taxes	8
The Tax Wedge	11
PAYE, or Pay as you Like	12
Corporation Tax Reductions	13
Which Vision for Society	13
Conclusion	14
Appendix	14
Bibliography	16

Executive Summary

Of late, a myth has grown up around the birth and, indeed, the conception of the Celtic Tiger. A growing number of influential commentators and politicians have taken to asserting that tax cuts were the key stimulus for the period of remarkable economic growth Ireland enjoyed between 1994-2001.

Indeed, they repeat this assertion as if it were a matter of established economic fact – an irrefutable economic law – rather than the political contention it actually is. To date this claim, dressed up as established fact, has gone largely unchallenged. Yet, an examination of the evidence reveals it has little basis in reality.

In fact, the evidence reveals that reductions in taxation followed the economic expansion – tax cuts did not spawn the Celtic Tiger.

The promotion of the myth that low taxes created the Irish economic ‘miracle’ is part of a wider, conservative political agenda which, in essence, seeks to limit the role of the state and maintain the benefits reaped by a small minority, during the Celtic Tiger years. For them, Ireland is a low-tax economy and self-interest dictates that it should remain so.

This of course requires that public spending – on health and education – is kept low and the tax regime does not become an instrument of wealth redistribution. The wealthy do not care too much about public services, as they can afford to buy these services privately.

As in every great lie, there is some truth in what the advocates of very low taxes claim. Yes, it can be said that very high taxes impede economic growth and encourage evasion. And yes, Ireland did have exceptionally high taxes in the early 1990s, along with a hefty debt and weak public finances. Much of this is attributable to gross mismanagement of the economy, from 1977 onwards.

Such high levels of public spending were not sustainable – particularly when the bulk of that spending was going to international banks, in the form of interest payments, rather than to finance decent public services.

This Congress briefing will show that, while average taxes may appear to have fallen, many taxes are still high - spending taxes, stealth taxes - and that some people pay no income taxes, pushing up the average for others.

It will also show that average taxes on incomes and wealth are not much below the average in Europe, because low taxes on some sectors here reduce the average.

And while there were tax reductions in the 1990s, the real cuts in income taxes did not occur until after 2000, just as economic growth tailed off. The cuts in income tax have been very substantial, but only in the past few years.

Thus, while tax revenue rose every year in absolute terms, it fell dramatically as a proportion of GDP. This was mirrored by a substantial reduction in current public spending.

Averages Disguise Much Unfairness

Our economic success preceded tax reductions, not the reverse.¹ Nonetheless, despite these much-trumpeted reductions, Ireland remains a relatively high-tax economy for many, when all taxes are taken into account. But for a privileged minority, Ireland is a low-tax and even a no-tax economy.

It appears as if Ireland is a low tax economy from Figure 1 (Total Government Revenue) below. Taxes as a percentage of GDP have fallen in recent decades; are much lower than all other European Union countries and close to the level that obtains in the United States. Total revenue for Ireland has fallen from 38 percent in 1990 to 33 per cent of GDP in 2004, well below the 44.2 percent average for the 15 EU (pre-accession) member states. Thus it may appear as if Ireland is currently a low tax economy. The reality is more complex:

- Ireland's GDP is exaggerated - the GNP figure is only 84 per cent of GDP in 2004 and this

¹ The reasons for that success are complex and outside the scope of this report. Nonetheless, there is a general consensus on that the success is not based on one or two factors, but on many. These included foreign direct investment, Social Partnership, an educated workforce, membership of the European Union, a stable macro-economic framework (as part of social partnership, the demographic dividend etc. Only those on the Right have asserted that the tax cuts were even a factor.

distorts Figure 1. Adjusting for GNP, Ireland moves up to around 36 percent, still quite low compared to most other countries;

- Because taxes are low for some groups, the average is reduced. For example, low corporation tax, low employers' PRSI contributions (see Fig 4), low taxes on property and the successful exploitation of tax loopholes by 'high worth' individuals, means taxes are higher than they should be for others. The net effect is to reduce the average tax take.
- When all taxes are computed together, a different picture emerges. Most working people pay a lot of their total gross income in taxes, mainly in spending taxes. The 'average' figure does not show how taxes are raised and on whom the incidence of taxation falls;
- While the overall burden of taxes has fallen, this reduction followed the economic boom. It did not precede it, as will be demonstrated. Effective rates on incomes did fall substantially, but not until between 1999/00 and 2002.

Property taxes in Ireland raise only half of the total tax take raised in the US, Japan and Canada, with even a higher proportion raised in the UK.² Further,

² OECD, Revenue Statistics, 1965-2001, Paris.

as shown in Figure 3 (Current Taxes on Incomes and Wealth), Ireland is not too far out of line in relation to other EU members, with taxes on income and wealth at 11.9 percent of GDP. The European average is 12.8 percent.

As there are no taxes on wealth in Ireland and taxes on capital are very low, this means that most tax is levied on incomes and on spending. And as some high earners avoid income tax completely, the rest of us pay more.

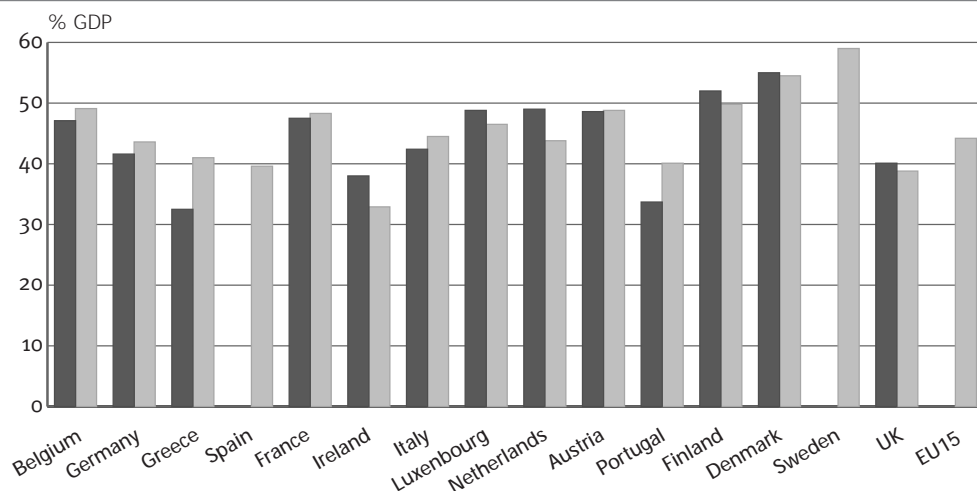
Some Reform, Some Progress

Some reform has occurred: the introduction of tax credits, the elimination of some, but not all, exemptions and loopholes for companies and the reductions in effective taxes on average incomes in the past few years.

The reduction in the tax rates, widening of bands and the introduction of credits instead of personal allowances grew out of Social Partnership. But the country still has high overall taxes on most workers, low taxes on high incomes and low taxes on all corporate entities.

A high proportion of every euro earned by the majority of Irish people goes in taxes, when all taxes on spending are included. Our taxes fund

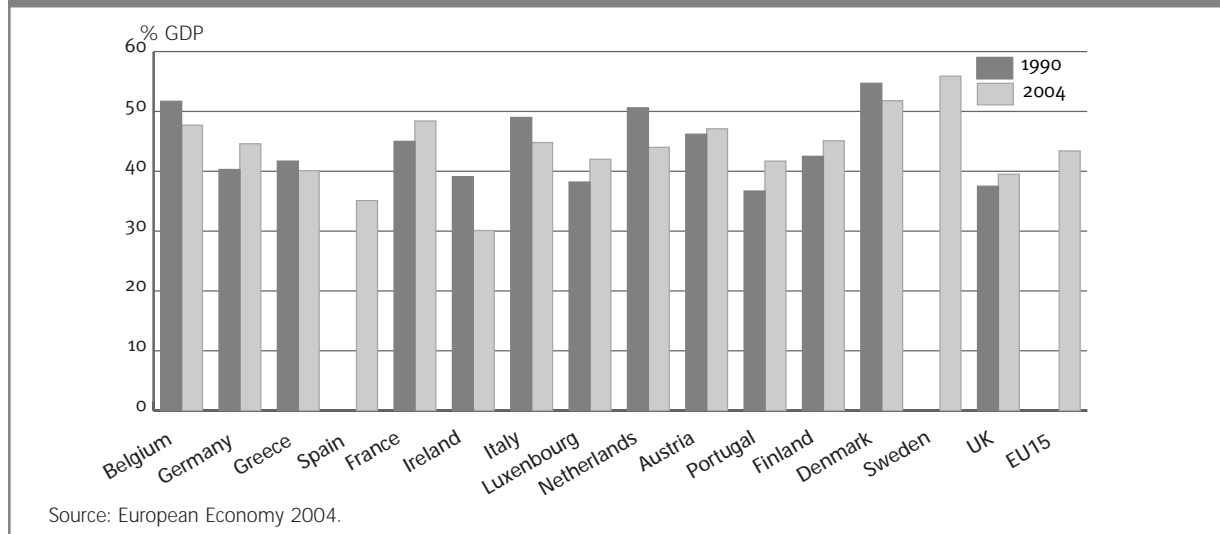
Figure 1: Total Current Government Revenue, 1990 and 2004



Source: European Economy 2004.

Definition: Total government revenue includes taxes on income and wealth, on production and on other transfers. It also includes taxes on property income, which are very low in Ireland (with no taxes on residential property at all) and from social security contributions, which are also extremely low.

Figure 2: Current Government Spending 1990 and 2004 for EU 15



necessary services like education and health and it is therefore a matter of simple justice that all contribute in an equitable fashion.

But, as constituted, our tax system is fundamentally unjust. It is far too heavily biased in favour of stimulating economic activity, which no longer needs state aid through tax expenditures. It is biased against those on low and middle incomes and it does not raise enough tax overall to pay for modern public services.

Figure 2 (Government Spending) shows that government spending has fallen from 39.1 per cent of GDP in 1990 to only 30.1 per cent in 2004. Again, if GNP was taken, it would be higher compared to the other EU countries, but it still shows how much spending has been cut compared to our past, while our population has risen and demands for modern public services have also increased. A number of economists have argued that relative to other European countries public spending is not low.³ However, others like O'Reardon concluded that Ireland's public spending is low, even if we factor in low defence spending and our low unemployment. He concluded that in comparing like with like, "public services in Ireland are generally underfunded" but he favours reform "in spending structures if public services are to be improved". Others, like Wren, were critical of those who asserted that public spending on health was a "black hole."⁴

The myth of the low tax economy spawning the Celtic Tiger is a powerful one. It is assisted by the fact that tax rates have been reduced in the recent years. But income tax is determined by combinations of rates, tax credits and rate bands. A cut in the top rate - from 56 percent to 42 percent today - is of no benefit to low paid workers.

The cuts in income taxes, in capital gain taxes, corporation and inheritance taxes, combined with the already narrow tax base, have reduced the overall level of taxes, as a percentage of GDP.

But, again, that does not translate into a universal, low tax economy.

It will be seen that effective tax rates did fall and fell substantially, but only in the past few years, at the very tail-end of the Celtic Tiger. Much of the credit for this has to go to the Congress strategy of focusing on disposable incomes, under Social Partnership.

³ De Buitlear and McArdle and Lawlor and McCarthy, both articles written in 2003.

⁴ O'Reardon, Colm, 2004. He was critical of views expressed by Donal De Buitlear and Pat McArdle and also by Colm McCarthy and J Lawlor in 2003. Meav-Ann Wren demonstrated that current health spending remained below the EU average in 2002 and that capital spending had been inadequate. This meant that the case for substantial investment remained unchanged.

SPENDING TAXES

Governments influence *spending* taxes in two ways:

1. Direct taxes like VAT and Excise, VRT etc, levied directly by the state and
2. 'Administrative Taxes' or Stealth Taxes, like waste charges, tolls, electricity, gas and telecom bills .

Our overall cost of living is now the highest in Europe, some 18 percent higher than the European average.⁵ A high proportion of this increased cost of living results directly from the increased taxes on spending and 'administrative taxes' - price rises and charges over which the government or its agents, such as regulators, have a strong influence.

The rapid rise in spending taxes and especially administrative taxes has been central to government policy, meaning that more people pay directly for public services such as motorways, hospitals and waste disposal.

The implicit tax rate on consumption in Ireland for 2002 was 25.8 percent, compared to a weighted average of 19.5 percent for the 15 EU members.⁶

Of the price rises in the year to August 2004, 28 percent were caused by increased indirect taxes. And over the last five years to early 2004, almost one quarter of the total rise in prices of over 22 percent was due to increased spending taxes. This means that government policy led a massive percentage increase in inflation, over the same five year period. On top of that, there were very rapid price rises approved by government or its agencies in 'administrative taxes'.

The government has a great deal of influence on 'administrative taxes'. For example, the government has a policy of "encouraging competition" in electricity by allowing high prices rises to encourage in new competitors (which are still slow to emerge). This means higher profits for ESB (part of whose profits the government takes in dividends). It has a policy of user charges or tolling roads as part of its policy to privatise public services. This essentially means a shift from taxes to user charges. So there may be a fall in tax, but other ways are found to take the money from citizens' pockets.

Taxes are for Little People

"Taxes are for little people," declared the US billionaire Leona Helmsley, as she was led away to prison on tax fraud charges. That dictum appears particularly appropriate to modern-day Ireland.

High-profile individuals such as Tony Ryan, Michael Smurfit and Denis O'Brien made literal fortunes in Ireland. But they live abroad and so avoid paying taxes here.

Equally, many resident high-earners avail of perfectly legal loopholes to minimise or avoid tax. Curiously, the government persistently refers to these loopholes – mostly based on property - as 'incentives'. Incentives for whom?

As is clear from Figure 3, direct taxes on income and wealth in Ireland are not significantly out of line with many other European countries at 12 per cent. It has been said above that the chart is based on GDP, but with GNP, the more accurate comparator, Ireland is actually slightly above the average.

The chart is based on the total tax take on *incomes and wealth* and because Ireland has no taxes on wealth, nor property taxes on residences - unlike virtually all other European countries - and low company taxes, this results in higher actual taxes, than those revealed by the chart.

The OECD warns that as capital is more mobile than labour, "there may be a need to reduce taxes on capital" and "most of the tax burden will have to fall on labour."⁷

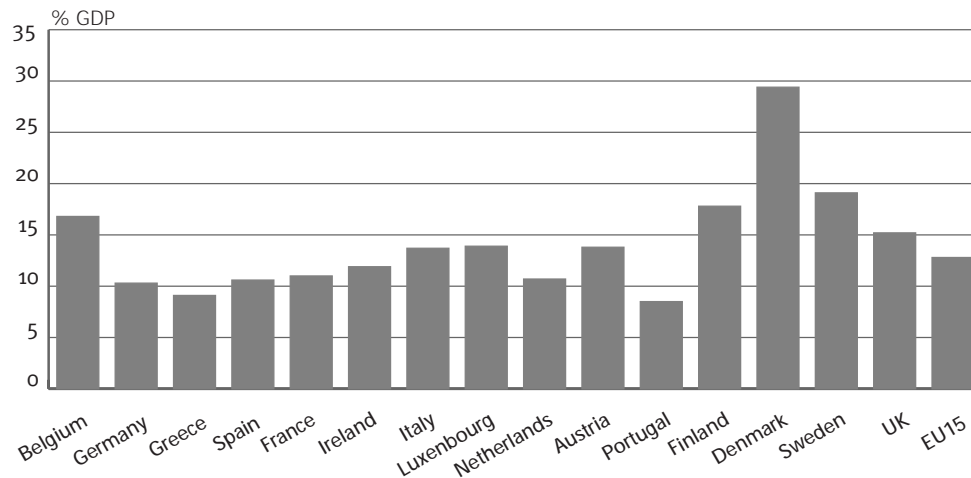
Figure 3 also does not show that the 'social contributions' paid by employers in Ireland are amongst the lowest in the (pre-accession) EU. However, this is revealed in Figure 4, which shows that only Denmark has a lower rate than ourselves (though it operates a low employers' social contribution as part of a holistic tax system which is both progressive and high (see Figure 1 which shows that tax revenue is high)).

⁵ National Competitiveness Council, 2004, Statement on Costs and Prices, September and Eurostat, 2004. Based on Purchasing Power Parities, Luxembourg.

⁶ European Commission, 2004, Structures of the Taxation Systems in the European Union 1995-2002

⁷ OECD, 1997, Taxation and Economic Performance, Working Paper No 176, Paris.

Figure 3: Current Direct Taxes on Income & Wealth, 2004



Source: European Economy, Spring, 2004.

Definitions: Income on employment, on self employment on property, pensions, taxes on companies ie Corporation Tax, taxes on holding gains. Taxes on winnings (none in Ireland). It also includes other taxes on land or buildings or on net wealth (none in Ireland), motor taxes, taxes on boats and on hunting and fishing licences and on international travel and foreign remittances.

Even the new member states have rates ranging from eight percent to 15 percent of GDP, according to Eurostat.

OECD data shows employer social security contributions for Ireland at amongst the lowest of its approximately 30 members, at just 10 percent of total labour costs in 2003. This compares to 29 percent in France, 28 and 27 percent in the Slovak Republic and Hungary, respectively, 25 percent in Sweden and Italy, 23 percent in Spain and nine in the UK.

Excise duty on drink and tobacco in Ireland is amongst the highest in Europe. VAT rates are also high in Ireland at 21 percent, compared to 15 percent in Luxembourg, 16 percent in Germany and Spain, 17 percent in Portugal, 17.5 percent in Britain, 19 percent in the Netherlands, or even 19.6 percent in France. However, as there is no VAT on many food products in Ireland, this reduces the impact of the high standard rate.

Taxes on spending make up almost half the total tax take in Ireland (see Fig 5)

In a letter to David Begg, Congress General Secretary, the former Finance Minister, Charlie McCreevy, stated that *"my priority is direct tax*

reductions to reward effort and enterprise and to let the taxpayer keep more of their earnings in their pocket" (our emphasis).

This means that when workers take money out of their pockets to pay for goods and services, they pay higher prices.

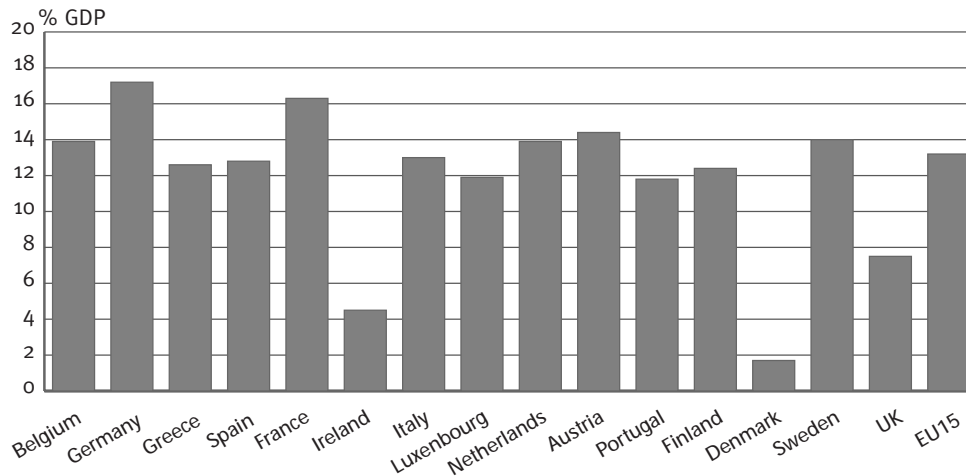
It also means that higher earners keep more in their pockets as they generally spend less of their incomes. The emphasis on "rewarding effort and enterprise" will be examined later.

While the government claims that it is reducing taxes and that Ireland is a low tax economy, the amount of tax has risen dramatically every year: from €10bn in 1990, to €27bn in 2000 and €33.4bn in 2004.

The rise in total taxes was made possible by the fact that there were many more at work, paying taxes, and high spending taxes.

However, as a proportion of GDP or GNP (as shown in Figure 1 and the converse in 2), tax take has fallen and fallen dramatically. It is reasonable to argue that the level of taxes raised are utterly inadequate for what is required to fund a modern European economy and society. The question is - who is not paying their fair share?

Figure 4: Social Contributions Paid to Government, 2004 (% GDP)



Source: European Economy, Spring, 2004.

Definition: Actual contributions paid by employers, employees and self employed and non-employed persons.

Rewarding Effort & Enterprise?

As noted above, former Finance Minister, Mr McCreevy, stated that the tax system should reward "effort and enterprise." While taxes on earned incomes have been reduced as part of the national agreements, for most people in Ireland, when they spend their after-tax incomes, they pay more for goods and services.

In the 1960s and early 1970s, tax on inheritances - when Ireland was much poorer - were substantially higher than today. Until the mid 1980s, the threshold on inheritance tax allowed one to inherit up to €190,00 tax-free. By 2003 this had more than doubled, to €441,198. Thus, a parent can leave €1.76m to four children and they will pay nothing in inheritance taxes. There are also major exemptions for inherited businesses, with even higher thresholds and lower rates. In the past, the rates were graduated progressively - rising from 25 percent to 50 percent for children.

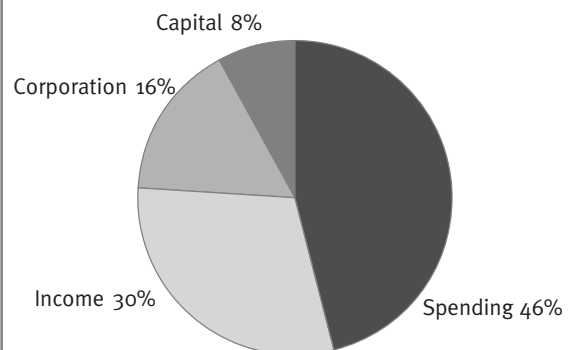
However, the progressive rates have been abolished and the top rate halved - from 40 percent to 20 percent. Again, this shows a distinct bias compared to the rate of taxes paid by those who work for a living. To add insult to injury, there is PRSI on benefits-in-kind (for low-paid workers with minor 'benefits'), but none is imposed on inherited capital or capital gains.

While work is taxed at 42 per cent, plus levies of six percent, the rate for speculation is just 20 percent. Inheritance is not taxed at all, unless it is serious money and then it is nominally taxed at less than half of what work is taxed at.

From an economic perspective, the halving of the rate of capital gains and of inheritance tax should never have been implemented, especially by a government which says that it seeks to reward work, effort and enterprise.

The theory of 'fiscal contraction expansion' was first propounded by Ronald Reagan and promptly mocked as 'voodoo economics' by George Bush

Figure 5: Sources of Taxes 2004



Source: Budget 2004.

Snr, his then opponent for the Republican Party nomination, and later Reagan's vice-president. There is an element of truth to this contradictory-sounding theory. When the tax rate is cut, there will be some movement to take advantage of it. Not alone did this happen in Ireland, but the halving of capital gains tax was implemented in the middle of a boom, in December 1997. The effect was to fuel an already overheated economy.

Nobel Laureate in economics, Joseph Stiglitz, is scathing of the impact of the reduction in capital gains tax, in the US. He is also critical of the reduction on other taxes too, for economic, political and social reasons.⁸

While this government has verbally espoused a "reward effort and enterprise" policy, in practice it has pursued an anti-work and anti-enterprise policy – with cuts in inheritance and capital gains taxes, many tax exemptions on property and high direct and indirect taxes on workers.

In other countries, taxes are levied on inheritance because it is seen as a relatively painless way of redistributing wealth. After all, inheritance taxes are levied on unearned capital. Many studies show

that Ireland is one of the most unequal countries in the world and a major reason is the tax system.⁹

There were Cuts in Tax Rates and in Income Taxes

It is recognised that when taxes are very high, there is incentive to both avoid and evade paying. In 1979 and early 1980, high tax levels brought hundreds of thousands of PAYE workers onto the streets in protest. The 'PAYE problem' was accentuated by negligible taxes levied on farmers and the self-employed. And, as we now know, there was also widespread and systematic evasion of tax. The issue was not just that the top rate of 56 percent was very high, but that workers on average earnings were paying at this rate, while so many others paid little or nothing.

Government finances were in a disastrous state, largely as a result of the spending spree that

⁸ Joseph Stiglitz, 2003, *"The Roaring Nineties: Why we're paying the price for the greediest decade in history"* Penguin Books, London. This is a wonderful passionate book, by an economist (!) on the US economy.

⁹ United Nations Development Programme reports, annually, New York.

Table 1. Jobs Growth Before the Tax Cuts

	Top Income Tax Rate (%)	GNP Growth	Annual Employment Increase ('000s)
1992	52	2.3	9
1993	48	3.4	18
1994	48	6.3	37
1995	48	8.3	61
1996	48	7.8	48
1997	48	9.7	50
1998	48	7.9	95
1999	46	8.9	97
2000	46	10.2	80
2001	44	3.8	46
2002	42	0.1	33
2003	42	2.5	34
2004	42	4.3	31

Sources: Budgets, CSO.

followed the 1977 election. In addition, the abolition of motor tax and taxes on residential property, combined with high unemployment, meant those in work were burdened to an even greater degree.

However, in 1987, following the conclusion of the first national agreement, the Programme for National Recovery, the foundations for recovery were laid.

The birth and rapid growth of the Celtic Tiger, provided the necessary fiscal latitude for the introduction of the cuts in taxes on income some years later, at the beginning of the 21st Century. They were a consequence of the boom, not a cause.

It can be clearly seen from Table 1 that economic growth did not follow reductions in the top tax rate.¹⁰ Further the massive growth in employment was well underway long before the reductions occurred. High GNP growth rates began in 1994, when the top rate stood at 48 per cent and it was to remain unchanged until 1999.¹¹

Growth in employment had begun to decline (for many reasons and few, if any, to do with tax cuts) by 2001. The following year there was no GNP growth, even though the top rate had been cut to 42 per cent.

Figure 6 illustrates that there was no real relationship between the top tax rate reductions and the changes in GNP growth. It could be facetiously argued that when the top rate was cut to its present level of 42 per cent, economic growth ceased. However, this would be as bogus as claiming that the Celtic Tiger was created by tax cuts.

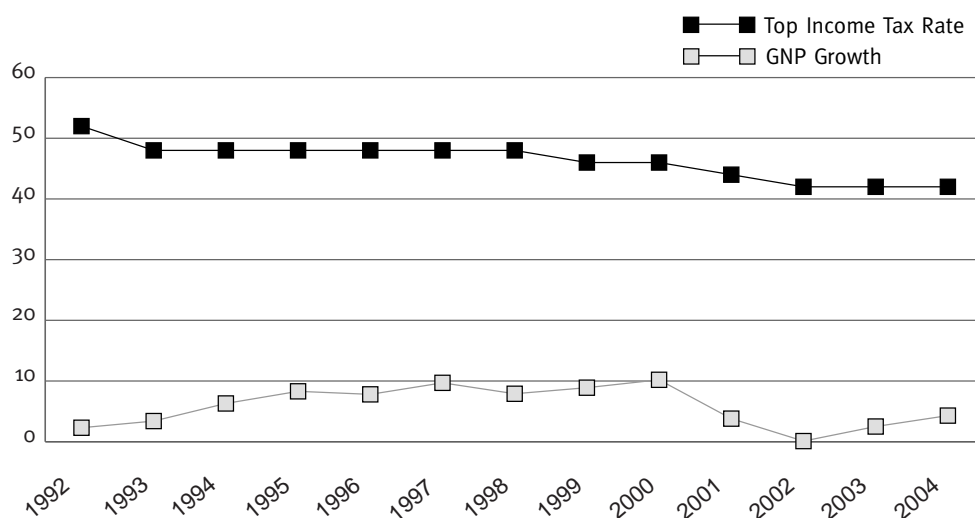
According to the OECD by 2003, total tax and social payments made by a single production worker in Ireland on earnings of \$25,613 was, at 16 per cent, lower than most other EU countries.¹² Figure 7 (over) shows the average effective tax rate on all income earned in Ireland each year between 1991 and the latest available year. It is based on the returns of all taxpayers, in all sectors, PAYE and self-employed and includes rents etc. It is based on total actual incomes for all in each year. As it shows the effective rate of tax - the average rate of tax on all income - it is a key indicator of tax changes.

¹⁰ Nor did it follow the reduction in the standard rate which was reduced (see next Footnote).

¹¹ Similarly the standard rate remained stable at 27 per cent from 1992/93 to 1996/7 and it was to be reduced by one per cent in 1997/98; by 2 per cent in 1998/99; then a further 2 per cent in 2000/01 and finally to the current rate in 2001. It had been 30 per cent in 1990/91 (with a middle rate of 48 per cent which was to become the top rate in 1992/93 when it was reduced).

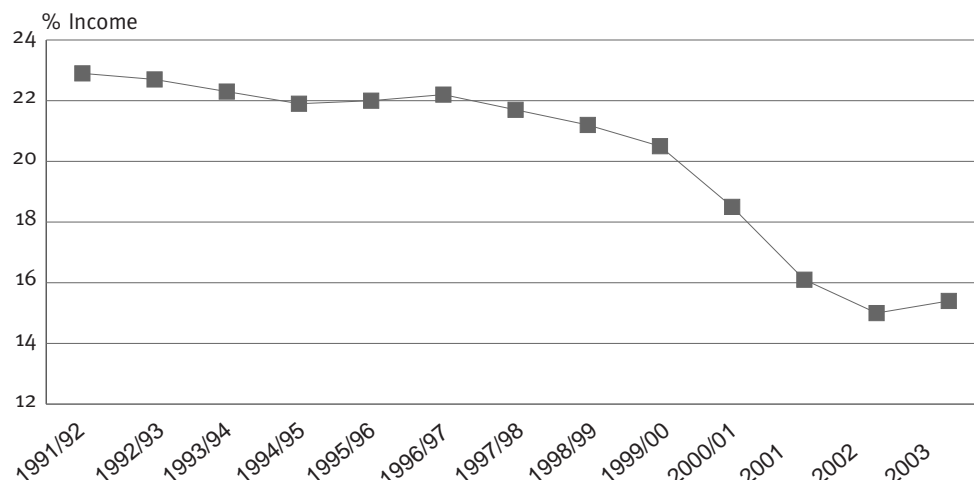
¹² OECD, 2002/03, Taxing Wages, Paris

Figure 6: Top Tax Rate and GNP Growth



Source: Budgets, CSO.

Figure 7: Average Effective Income Tax Rates on all Incomes, 1991-2003



Source: Revenue Commissioners Annual reports 1992-02, table IDS19. Figures for last three years are estimates and were supplied by the Revenue.

Definition: This table is based on all income tax from all sources, PAYE, self-employed, rental incomes, etc. for all taxpayers. The effective tax rate is the average tax levied on each euro of total income, after with standard rate reliefs and DTR, and excludes capital allowances of the self-employed.

Figure 7 clearly shows that the average effective tax rate did not begin to fall until 1996/97 and then fell very slowly. This reduction was not significant enough to engender any real change in work patterns or enterprise, until after 1999/00.

Effective rates paid by the 'average taxpayer' ranged between 22.2 percent and 22.9 percent between 1991 and 1997 and was still over 21 percent in 1998/99. They fell to 20.5 percent in 1999/2000, to 18.5 percent in 2001/01, were reduced again in the short tax year of 2001, before falling to just 15 percent in 2002. Thus, the material reduction in income tax did not occur until the Celtic Tiger had virtually run its course, in 2001 (see table 1). The effective tax rate rose again in 2003, to 15.4 percent. The graph does not include the social payments which are generally six percent.

Figure 8 shows that the average industrial worker saw small reductions in their effective rate of income tax, during the 1990s, but the material tax cuts did not occur until after 1999/2000.

In 1993/94, the average industrial worker saw a small rise in the effective tax rate, up again to

almost one quarter of his/her total earnings. The rate was not to fall below one-fifth of total earnings until 1998/99.

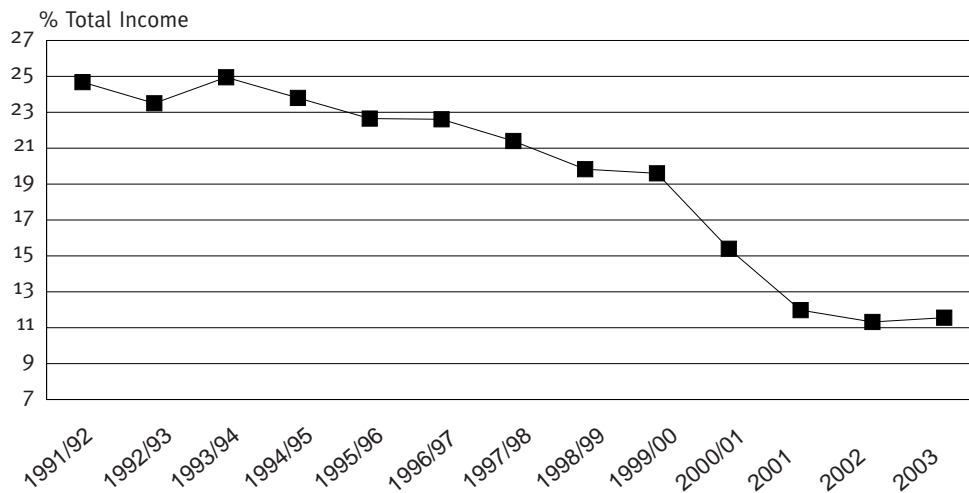
It was reduced to 15.4 percent in 2000/01 and has been just under 12 percent for the past three years. The reductions in the effective rates in recent Budgets have been substantial - average industrial workers were paying over one-quarter of their total income in tax in 1993/94. Today it is down to just one-eighth of total income. However, the tax reductions did not impact on workers' earnings until 2000.

The reductions were agreed under the auspices of Social Partnership. While workers' pay rises were modest for most of the 1990s, real take-home pay increased significantly with the tax reductions included.

With the reductions in income tax, it can be argued that the state effectively subsidised employers by reducing wage demands. This factor may have assisted in the substantial job creation of the Celtic Tiger years.

This issue of wage determination is complex and oft-debated. The share of the national cake going

Figure 8: Change in Effective Income Tax Rate on Single Industrial Earnings 1991-03



Source: Revenue Commissioners Annual reports 1992-02, table IDS19. Figures for last three years are estimates and were supplied by the Revenue.

Definitions: The industrial earnings were from CSO data and the rates in the tables in the Revenue reports were recalculated to the earnings figures for each year. The effective tax rates are computed for PAYE workers by reference to personal tax credits for persons aged under 65 years, including the PAYE individual tax credit, where applicable.

to profits has increased dramatically as the wage share was correspondingly reduced.¹³

This trend was assisted by the tax subsidies to employers, which moderated wage claims and left more profits with them.

Employment grew by an unprecedented 62 percent between 1989 and 2004, but it can be seen from Table 1, that most of the new jobs were created in the period 1994-2000, with a significant tapering off from that year. However, it was the 600,000 additional workers, the far lower dependency ratio and rising real incomes which enabled income tax rate reductions, not the other way around.

Studies have shown that those on higher incomes gained most from the tax reductions. Persons on the minimum hourly earnings still have to pay income taxes in Ireland. The other major downside of the overall tax reductions is that we still have poor public services, in spite of the rise in total taxes. This rise did not keep pace with the growth of the economy and the increased demands for public services.

The Tax Wedge

The 'tax wedge' describes the difference between what it costs an employer to employ someone, and what that person takes home. It has been reduced dramatically in Ireland and this has helped employment growth, especially for the low paid.

Between 1996 and 2003, Ireland's tax wedge, for a married production worker, stood at 18 percentage points.¹⁴ The next biggest fall was much lower than the cut in the Irish rate at 9.9 percentage points for Hungary, followed by the US at 8.3 percentage points. A number of countries had rises in the tax wedge, some of them quite large.

However, a reduction in the tax wedge comes with some costs. It is not necessarily good news for all. It presents a dilemma for trade unionists and those who see the necessity of a good social welfare system, because employers' PRSI contributes much to funding that system. It has

¹³ The issue of the massive swing in the national cake going from wages to profits is complex in Ireland. Transfer pricing has an impact, as does the very substantial growth in profit levels in recent years, the increased economic activity etc.

¹⁴ OECD, *Taxing Wages* ibid.

been seen that Denmark has low employers' social contributions but has very high overall taxes, which are progressive and equitable and it has superb social services.

With the major cuts in corporation tax, employers have had it good in Ireland. The reduction in employers' PRSI - only 10.75 percent of earnings, down from 12 percent in 2002 – has seen them receive an additional, substantial bonus.

The reduction in taxes on incomes also helped in reducing the 'tax wedge', thus creating more employment, especially low-paid and part-time workers, where the 'wedge' is important and unions influence on the National agreements were of some assistance in this regard.

PAYE or Pay as You Like?

A survey of the top 400 earners (not to be confused with the top taxpayers), conducted by the Department of Finance Tax Strategy Group, shows that of the top 117 earners in Ireland, 29 pay no tax at all (see Table 2 below).

A further one third paid an effective rate of less than nine percent on their incomes. These high earners managed to avoid taxes - totally in many cases - by engaging in legal avoidance schemes, such as owning racehorses, or owning property. These are not the top or marginal rates but average rates of tax paid. Taxes are indeed for 'little people', in modern-day Ireland.

This 117 'taxpayers' are taken from the top 400 and had an effective rate of under 30 percent. Of the others on the top 400 list, 231 had an effective rate of between 30 and 44 percent and 52 had an effective rate of 45 percent.

Commenting on this massive avoidance by Ireland's top earners Ireland, the Government's Tax Strategy document, stated "the 2002 study indicated that property-based capital allowances continued to be the chief instrument used by high-income earners to reduce their taxable income by substantial amounts."¹⁵

Subsequent to this finding, in Budget 2003, the then Finance Minister abolished capital allowances for investment in registered holiday homes and reduced capital allowances for hotels to the four percent per annum rate, applying generally to industrial buildings. He also indicated that a range of property-based tax incentives including the Urban Renewal, Rural Renewal, Student Accommodation and Car Park reliefs would not be extended beyond their end-2004 termination date, thereby further reducing the opportunities for high earners to reduce their taxable income by substantial amounts.

However Mr McCreevy did not make good on this promise. Rather he extended the time period of most of these loopholes.

¹⁵ Tax Strategy Group, Tax Incentives and Broadening the Tax Base, TSG No 03/27, 2003.

Table 2. Distribution of Effective Tax Rates 1999/00 of the Top 117 Earners

Effective Rate	No Of Cases	% of Total
0%	29	24.78
< 5%	22	18.80
5% to 9%	12	10.26
10% to 14%	10	8.55
15% to 19%	12	10.26
20% to 24%	19	16.24
25% to 30%	13	11.11
TOTAL	117	100

Source Tax: Strategy Group Paper No 03/27.

Note: the effective rate of tax is the rate of tax on the total income, not to be confused with the marginal rate, which is the rate at the top of the income.

The government has considered a minimum tax rate for the top earners to eliminate this kind of avoidance, but because most of the top tax payers do pay tax at higher rates than the rate proposed, they decided it might encourage tax planning and lower effective rates. This happened in the US, where the Alternate Minimum Tax - introduced in 1969 - saw the average rate fall in the last decade. Thus the best way forward would be to eliminate most of the tax breaks, as Mr McCreevy had initially promised.

While workers on average industrial earnings in Ireland pay tax at the top rate, some of the very highest earners pay no tax at all, legally.

In Autumn 2004, average industrial earnings, including overtime and all additional payments, stood at €575 per week, or €29,900 a year. That is taxed at 42 percent, and PRSI at six percent.

In shops, the average earner pays VAT at 21 percent and pays more taxes in the pub.

Their only consolation is that the high earners also pay high spending taxes (if they reside in Ireland). However, high earners have a propensity to spend a smaller proportion of their incomes than those on lower incomes and so are less vulnerable to spending taxes.

Corporation Tax Reductions.

Table 3 (below) shows the reductions in the standard rate of corporation tax. Economic growth slowed when the lowest rates were reached. The rates were dramatically reduced from 40 percent for the first half of the 1990s and now stand at just 12.5 percent (with a lower rate of 10 percent for manufacturing and some others, until 2010). Again, if the rate reductions were plotted (as in Table 1) and imposed on the GNP and employment growth, it will be seen that growth was not induced by the reductions in company taxes.

Which Vision for Society?

Does the tax system serve us well as a nation and a society? Do we want to live in a society with little poverty and first-class health and education systems, like many other European states? Do we want to grant access to all and build the much vaunted "knowledge society" with public investment? Or do we wish to continue with creaking public services and cash in the pocket for many. But where the cash is not stretching far, with high prices - sustained with high and rising stealth taxes, where we must pay directly for anything and everything?

Is this a fair society, is it raising sufficient revenue to pay for a modern European, socially-inclusive and efficient state? Are we investing to build the future competitiveness of the country with public

Table 3. Corporation Tax Rates

The Years	The Rates
April 1991-1995	40
April 1995-1997	38
April-Dec 1997	36
Y/E 1998	32
Y/E 1999	28
Y/E 2000	24
Y/E 2001	20
Y/E 2002	16
Y/E 2003 et seq.	12.5

Sources: Budgets.

funding of education and infrastructure?

The current tax system has many loopholes and some taxes hit the less-well off hardest. It is not raising sufficient money to fund European standards in health, education etc. However, it does appear to be the clear choice of this government to adopt the American economic model over the European – Boston over Berlin.

Conclusion

The Celtic Tiger has been created by many factors. There is general agreement among economists that this is the case. While there have been surprisingly few analyses addressing the causes of the Celtic Tiger, none of the few articles by academic economists on the causes have cited tax reductions as a major factor. This is because it is quite clear from the data that the Tiger was roaring well before governments were able to reduce taxes.

It has been seen that the purveyors of the 'low tax economy' have conveniently ignored the distribution of the incidence of taxation. Overall taxes may be low as a proportion of GDP or even GNP, but this is because many pay little or no tax. Average workers pay high taxes in total in Ireland and the overall tax system is still quite regressive, that is, it hits the poor hardest.

While some economists argue that low direct taxes stimulate economic activity others hold a contrary view. The OECD argues that reform can help economic performance, but concluded "it is clear from the literature review ... that the effects of taxes on economic performance are ambiguous in some areas and unsettled and controversial in others."¹⁶ There is, however, general agreement that low taxes on inherited wealth, on capital gains and unearned income are not an incentive to work and to enterprise. It has been seen that the government does not reward effort and work, but taxes it at much higher rates than capital gains or inherited wealth.

The cuts in income tax over the past few years have been substantial. Mr McCreevy did succeed in his plan to "allow taxpayers to keep more of their earnings in their pockets." But when they go to spend this money, they meet the highest price

levels in the whole of Europe. This is according to the government's own advisory body on competitiveness and EU data. Taxes on spending are generally regressive while income taxes are largely progressive - this policy hits the less well-off hardest and is of greatest benefit to the rich. There is therefore a very strong case for a re-balancing of the tax base, with a shift to lower taxes on spending to higher on higher incomes, but most importantly with a dramatic cut in loopholes, exemptions, and incentives which distort the tax base to the benefit of the very well-off.

It has also been seen that the high economic growth rates and the excellent job creation in Ireland in the 1990s preceded the cuts in the rates of taxation. It was the additional 600,000 workers, paying taxes on incomes, PRSI and high spending taxes that increased the total tax take by the Exchequer, combined with booming economic activity and soaring profits which enabled the reductions to then take place. Most of the tax reductions were not progressive.

It is clear that income taxes have been reduced, but this followed the Celtic Tiger Boom. Tax cuts did not generate the boom. Tax cuts were the result of the boom. The tax cuts have been on income tax, which is largely progressive. Spending taxes have been steadily raised by government with almost one quarter of the rise in inflation being actually due to direct rises in taxes on spending like VAT, and excise. On top of that administrative taxes have also been raised, largely as part of deliberate government policy to encourage "user charges." It is government policy to continue to rise these taxes much further.

Appendix

The key players in asserting that low taxes had been "the key to our recent economic success" and that "Ireland is a low tax economy" are Ms. Mary Harney, former Tanaiste and current Minister for Health, Mr. Michael McDowell, Minister for Justice, former finance Minister, Mr Charlie McCreevy and a number of financial and stockbroker economists.

Ms Harney has claimed that low taxes drove the

¹⁶ OECD, 1997. Taxation and Economic Performance.

Celtic Tiger: "If we don't have low taxes on capital, foreign capital will not flow in and domestic capital and the knowledge we create in Europe will flow out ... The tax burden on enterprise (the new word for business) must also be low if we are to achieve the dynamic, enterprise economy throughout Europe that we deserve and the people deserve."¹⁷

She restated the government's opposition to "any harmonisation of direct taxes"- which is the code for any attempt to make the corporate sector in Ireland pay taxes at reasonable rates, other than the very low the maximum rate of 12.5 percent.

"The tax burden on labour must be low to encourage employment. In Ireland we followed this agenda and it worked,"¹⁸ she asserted in the same speech. It will be shown that taxes on labour on PAYE workers, while much lower than the high rates in the past, are far from low in Ireland in 2004.

Mr McCreevy claimed that "our low tax strategy has paid huge dividends."¹⁹ The 2004 Budget said that "consolidating and preserving the employment-friendly income tax environment that has been achieved through the budgetary policy of previous years is now of paramount importance"....

And it sought to copperfasten the achievements of previous years by maintaining "a low tax burden."²⁰

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¹⁷ Mark Brennock, "Harney calls for low-tax liberal EU," Irish Times, 17th January 2003. Ms Harney urged the EU to adopt the Irish "Government's low-tax, liberal economic policies, both the create jobs and win back popular support for the union."

¹⁸ *ibid*

¹⁹ Charlie McCreevy, "McCreevy Defends low tax as key to economic Success" Irish Times, 25 June, 2004. When the conservative French Finance Minister, Mr Sarkozy sought to stop Structural Funds to Ireland and other low company tax Member States who are leading the race to the bottom with tax competition, Mr McCreevy changed his emphasis. "you wont have economic success solely by taxation", Irish Times 11 September 2004.

²⁰ Budget 2004, page E.18.

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