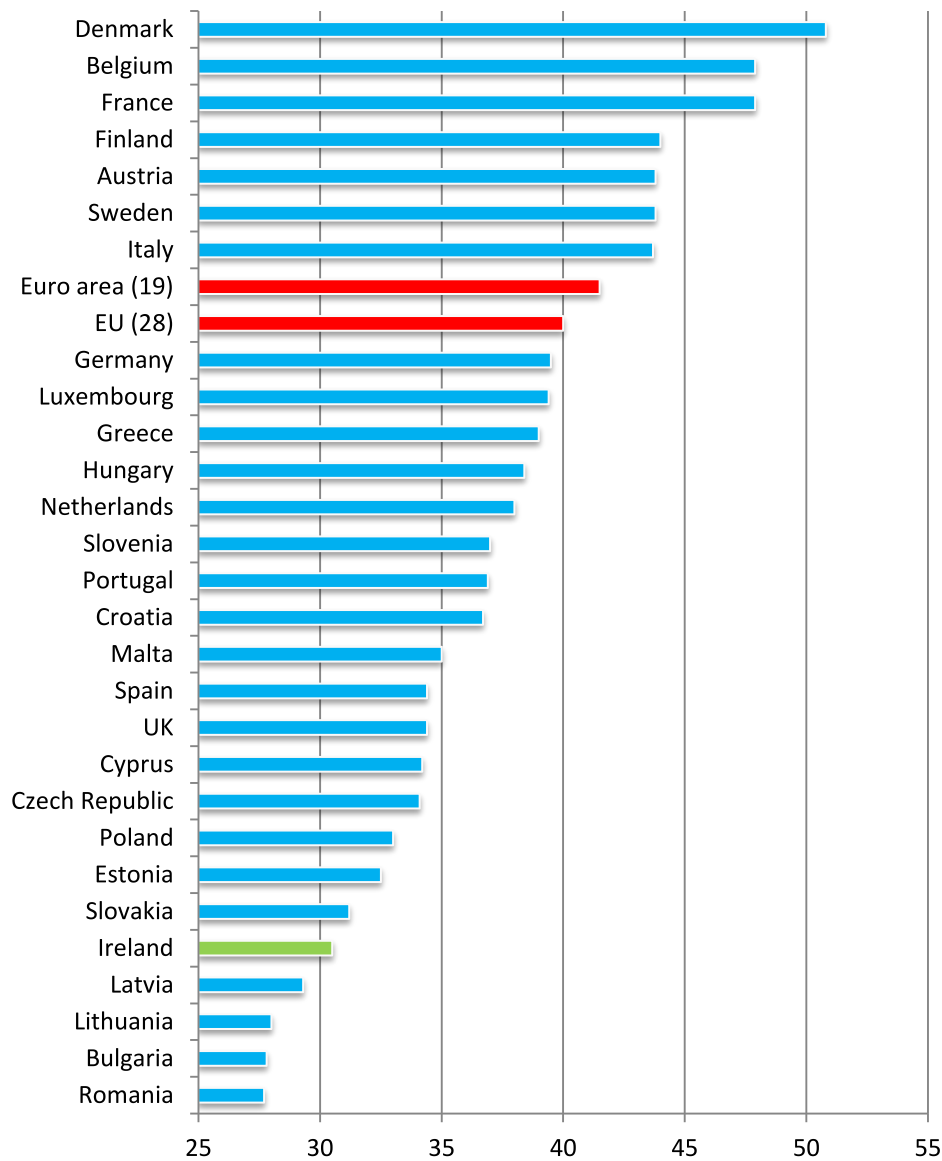
The Truth about Ireland's Taxation System

Ireland has the fifth lowest revenue to GDP ratio in the European Union. Revenue includes taxes and social security contributions. The Irish figure was 30.5% and the EU figure was 40%. From this we can conclude that:

- Ireland can be characterised as a **low revenue economy;**
- Our tax system is more in line with medium income economies of **central and eastern Europe** than with high income economies of western and northern Europe;
- The **most competitive economies in Europe** e.g. Denmark, Finland, Germany, Sweden are all high tax economies. They use their revenue base to enhance the productive capacity of their economy through spending on education, Research & Development, Childcare and infrastructure. This boosts the wider economy but critically it **also helps reduce costs for working people** in key areas such as childcare, transport and also housing;
- Our low revenue level is **not compatible** with western European quality public services;
- Our weakness with regard to investment in key services and capacity -is illustrated in the Appendix (below)

Chart 1: Government Revenue as % of GDP, EU member states, 2014



As **Chart 2** below makes clear Ireland is a low tax and low public spending economy. The dramatic increase in Irish public spending in 2010 was caused by the bank bailout and in particular the bailout of Anglo Irish Bank and AIB.

Chart 2: General Government Expenditure & Revenue (% GDP)

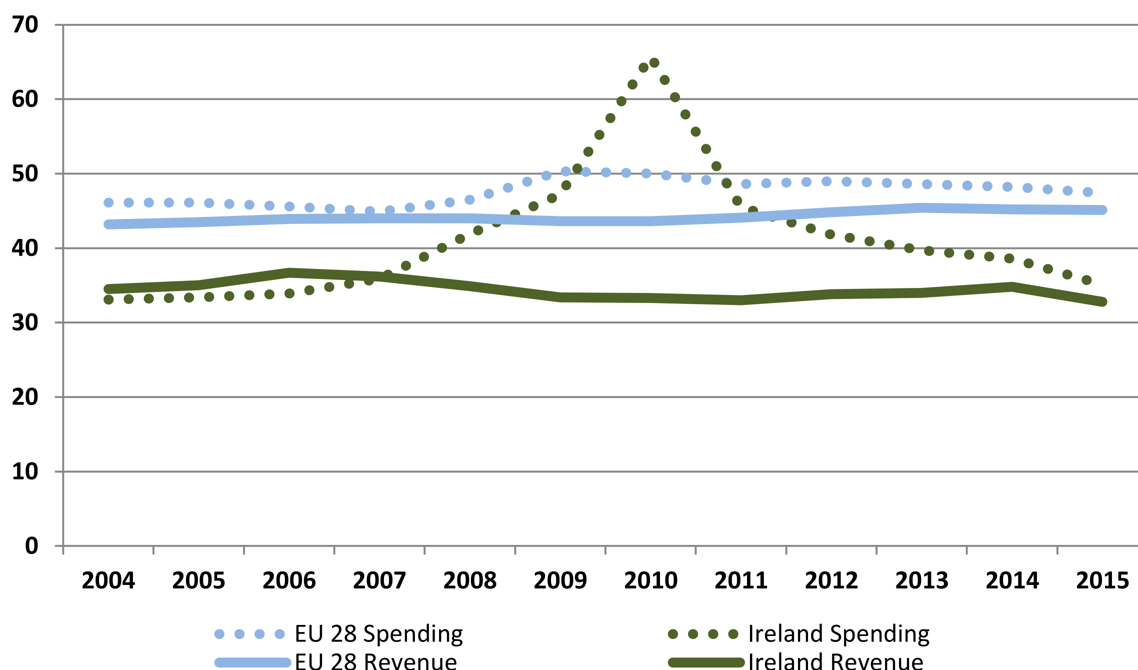


Table 1 shows the direction of fiscal policy between now and 2021, before the €11.3 billion of available fiscal space is allocated. This makes it abundantly clear that the 'revenue gap' between Ireland and the rest of the Euro area will deepen with consequences for public spending. This is before considering the further €2.8 billion of tax cuts envisaged in the programme for government. We can again make some points:

- Public services will come under immense stress in the medium term. A simple comparison of spending in 2015 with spending in 2021 makes this clear (highlighted in yellow). This is in the context of gradually increasing demand pressures related to the aging of the population.
- The only way this outcome can be prevented is through a reversal of fiscal policy to abandon tax cuts and/or the rainy day fund. Government revenue will be well below even the UK by 2021.

As **Table 2** (below) makes clear, Ireland is not a low tax economy when it comes to taxes on consumption. The main deviation is in relation to taxes on labour. If we unpack this further we find that labour taxation on employees is in line with EU norms **but that the employer contribution in terms of social insurance** is less than half the EU average.

Table 1: Revenue and Expenditure Comparisons (% GDP)

	2015	2016	2017	2018	2019	2020	2021
Revenue							
Ireland*	32.8	30.9	30.3	29.9	29.7	29.5	29.4
Euro area	46.5	46.2	45.9	45.9	45.8	45.8	45.8
United Kingdom	35.7	36.5	36.7	36.7	37.1	37.0	37.0
Ireland (% GDP-GNP Hybrid**)	36.2	34.2	33.6	33.2	33.1	32.9	32.9
Expenditure							
Ireland*	35.1	32.0	30.7	29.6	28.6	27.5	26.6
Euro area	48.5	48.1	47.4	46.9	46.5	46.3	46.1
United Kingdom	40.2	39.7	38.9	38.0	37.0	36.5	36.4
Ireland (% GDP-GNP Hybrid**)	38.7	35.4	34.0	32.9	31.8	30.7	29.8

Notes

**Base projections for Ireland are from the Department of Finance's 2016 SPU and are before allocation of unused net fiscal space. Estimates predate the 2015 level shift in Irish GDP. Other ptojections are from the IMF's Fiscal Monitor.*

***NERI estimates. The GDP-GNP Hybrid refers to the 'hybrid' measure of GDP and GNP developed by the Irish Fiscal Advisory Council as an estimate of Ireland's fiscal capacity.*

Table 2: Comparison of Revenue by Type (% GDP)

		2010	2011	2012	2013	2014
Taxes on Consumption	Ireland	9.9	9.4	9.5	9.8	10.1
	EU	10.7	10.9	10.9	10.9	11.0
Taxes on Labour	Ireland	12.1	12.6	12.9	12.9	13.1
	EU	19.1	19.2	19.4	19.6	19.6
Taxes on Capital	Ireland	6.0	5.7	6.0	6.1	6.5
	EU	7.5	7.7	8.0	8.1	8.2
Breakdown of Labour Taxation						
Paid by Employers	**Ireland**	**3.2**	**3.3**	**3.0**	**3.1**	**3.3**
	EU	**7.7**	**7.7**	**7.7**	**7.7**	**7.7**
Paid by Employees	Ireland	8.8	9.2	9.6	9.6	9.7
	EU	9.5	9.5	9.8	9.9	9.8
Paid by Non-employed	Ireland	0.1	0.2	0.2	0.2	0.2
	EU	1.9	1.9	1.9	2.0	2.0

Notes

Data for EU represents weighted averages. Taxes on labour includes social contributions.

Average Tax & Marginal Rates

Like every tax system the Irish tax system has its idiosyncrasies. The Tax Institute has pointed out that the marginal rates takes effect close to the average wage and that this is very early by OECD standards.

However, as OECD data makes clear (go to Table I.5 on the left hand side or see chart 2 here) the average tax paid by a single person earning the average wage is actually amongst the second lowest in the EU. The amount of tax paid by an Irish employee earning the average wage is just **19.7%.**

The apparent contradiction of high marginal rates and low average rates is caused by the generous system of tax credits. Tax credits reduce the actual tax paid by income earners in Ireland so that the average and marginal tax rates are very different in practice.

Even the headline average tax rate overstates the tax 'burden' as income earners can reduce their tax bill by using the system of available tax reliefs e.g. for private pensions or private healthcare.

While it is true that the average effective tax rate has increased since 2008 it must be remembered that effective tax rates are much lower than they were in the high growth 1990s. Taxes were increased post-2008 because Ireland was running double digit deficits in its public finances. These were not temporary increases but structural changes to restore sustainability to fiscal policy.

Ireland's overall tax and benefit system is highly progressive. As a result of this progressivity Ireland comes in mid-table in the EU in terms of post-tax & benefit income inequality.

If steps are taken to reduce this progressivity (e.g. by switching away from labour or capital taxes in favour of more consumption taxes) then Ireland will fall into the bottom half in terms of income inequality. In addition, Ireland already has a high effective tax rate on consumption (see Table 3 below). Moves to reduce the USC and increase taxes on excise goods should be viewed in this context.

Table 3: Implicit Tax Rates, (% of potential tax base)

		2010	2011	2012	2013	2014
Consumption	Ireland	22.2	21.5	22.0	22.7	23.7
	EU26* (Unweighted)	20.9	21.2	21.3	21.5	21.8
Labour	Ireland	29.0	31.5	32.5	33.2	34.4
	EU28	35.4	35.8	36.1	36.5	36.4
Capital	Ireland	13.0	13.0	-	-	-
	Euro area**	27.4	28.9	-	-	-

Notes: **Unweighted country average. Excludes Ireland. Data for Croatia not available.*
*** Not all EU countries reported the ITR on capital. More recent data is expected in 2016.*

Finally, the public finances are still in deficit and Ireland has a relatively high debt-to-GDP ratio.

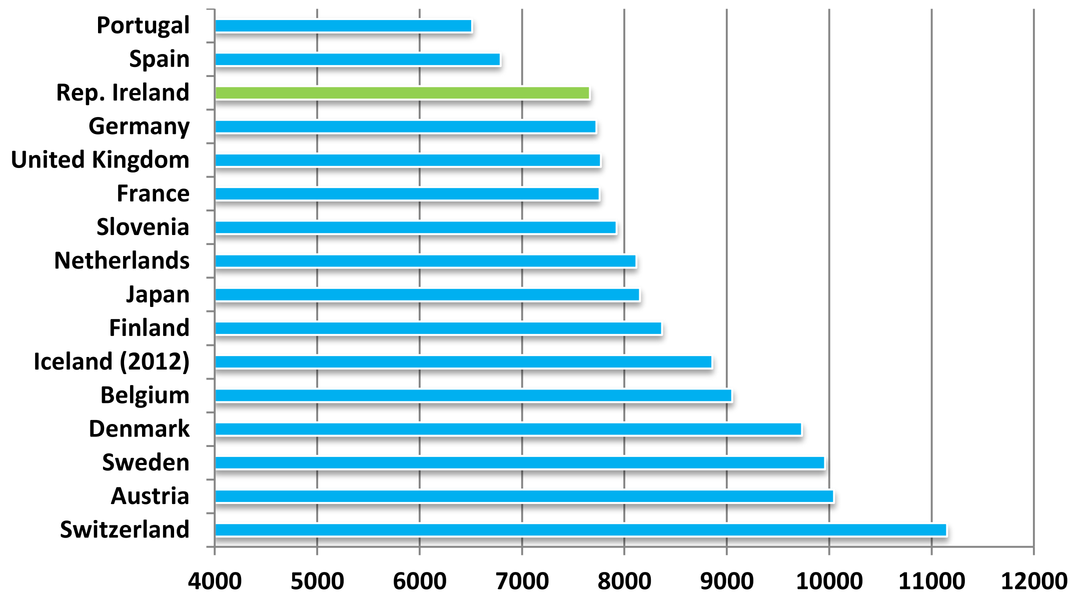
Our high debt level suggests the need for a cautious approach to the use of the fiscal space that focuses on measures to improve the economy's productive capacity.

There is no meaningful scope to reduce the overall tax take and any tax cuts should be paid for through compensating measures to raise government revenue elsewhere. Areas where revenue could meaningfully be increased include employer PRSI, environmental and property taxes. For example, Congress has proposed a net wealth tax on assets over €1 million.

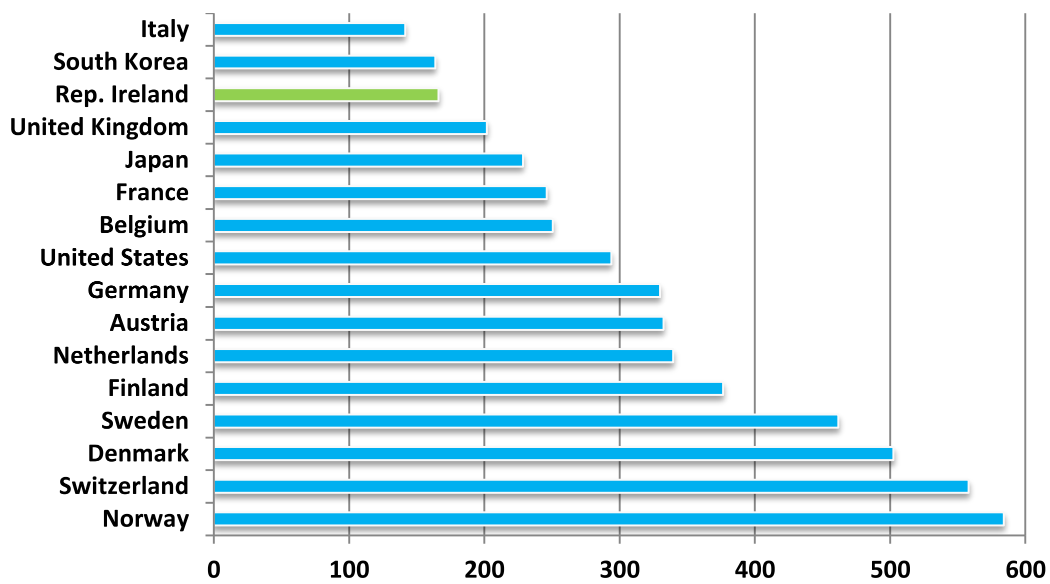
To read the NERI blog on this, go here: http://www.nerinstitute.net/blog/2016/10/01/tax-heresies-and-halfbaked-truths/)

Appendix

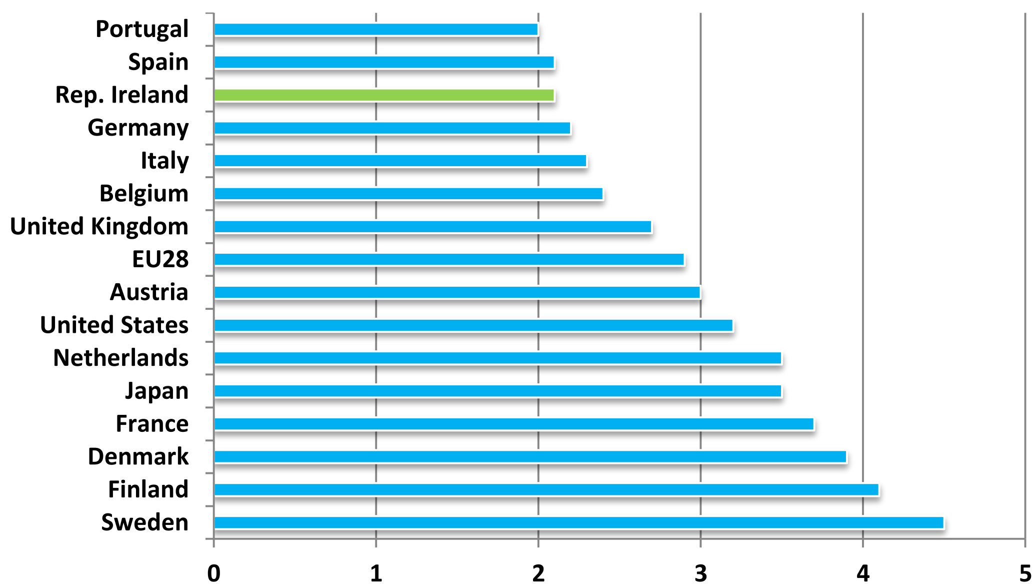
1. Public spending on education institutions per pupil in 2013, selected countries (PPS)



2. Per capita spend on public sector R&D, 2014, selected high income economies, (€)



3. Gross fixed capital formation in 2014, general government, (% GDP at market prices)



ENDS