Statement to the Committee on Budgetary Oversight
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Dr. Karina Doorley, Prof. Seamus McGuinness, Prof. Conor O'Toole

ESRI

Let me begin by thanking the Chair for the invitation to the ESRI to appear before the Committee. I am Dr. Karina Doorley. I am joined by my colleagues Prof. Seamus McGuinness and Prof. Conor O'Toole. We are happy to provide our views on the report of the Commission on Taxation and Welfare. Over the course of a year, the Commission prepared a thorough and evidenced-based examination of the suitability and sustainability of the taxation and welfare systems in Ireland. Chapters 9 to 12, on which we focus today, explore the themes of promoting enterprise, benefit adequacy, universal basic income, work incentives, and the sustainability of the Social Insurance Fund.

Promoting Enterprise

Part of the brief for the Commission was to explore the functioning of the tax system in relation to its objective of promoting enterprise. The focus of the review was to address the dual role taxation can play in terms of both attracting and retaining foreign direct investment firms (FDI) but also supporting the development of indigenous enterprises, in particular micro, small and medium-sized enterprises (SMEs). In relation to taxation policy for multinationals and larger enterprises, the Commission generally endorses the current corporate tax strategy, in particular participation in international efforts to tackle aggressive and harmful corporate tax practises by corporates (including the proposed two-pillar solution). Given the importance of the FDI sector to Ireland's economic performance, the alignment of Irish policies to those from upcoming multilateral agreements is understandable. Further discussion by the Commission could have been focused on the specifics of the Irish situation in terms of its sectoral structure and in managing risks relating to the concentration of corporation tax revenues and their sustainability.

Considerable emphasis was placed by the Commission on differentiating between the appropriate taxation measures for larger and small firms (in particular those at the start up or pre-revenue phase). This is an important distinction and addresses the well-established fact that small firms face very different challenges to larger enterprises when it comes to credit access, encouraging capital expenditure and the cost and time of tax procedures. The development of bespoke instruments for SMEs to help encourage equity investment as a financing instrument through a revamped Employment Investment Incentive Scheme (EIIS) and the extension of Entrepreneur Relief to angel investors are welcome and address known issues of low SME financial diversification in Ireland.[1] These instruments can help deal with long standing issues around credit access for SMEs and their reliance on debt financing. Further important suggestions relate to measures to help foster productivity enhancing investment, in particular the targeted R&D relief. Irish firms have been shown to have low levels of productivity[2] and low expenditure on R&D[3]; a more targeted R&D instrument may help to increase R&D spend and drive productivity enhancing investments. In general, having differential policies and procedures for small firms throughout the tax system should be a key takeaway from the Commission's report and can help foster enterprise development and job creation.

Benefit adequacy

The Irish tax-benefit system performs more redistribution than most other European systems.[4] While inequality in market income is higher in Ireland than in most other European countries, inequality in disposable – or take-home – income is close to the European average. There is a trade-off inherent to such redistribution through means-tested benefits or progressive taxation.

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[1] Lawless, M., C. O'Toole and D. Lambert (2014). Financing SMEs in Recovery: Evidence for Irish Policy Options, Dublin: Department of Finance and the ESRI, https://www.esri.ie/publications/financing-smes-in-recovery-evidence-for-irish-policy-options

2 OECD (2019), SME and Entrepreneurship Policy in Ireland, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, https://doi.org/10.1787/e726f46d-en.

[3] Cantillon, L., E. Gargan, J. Kren, M. Lawless and C. O'Toole (2022). Recent trends in SME investment in Ireland: exploring the pandemic and barriers to growth, ESRI Survey and Statistical Report Series 113, Dublin: ESRI, https://doi.org/10.26504/sustat113

[4] Roantree, B. (2020), Understanding income inequality in Ireland, Journal of the Statistical and Social Inquiry Society of Ireland.

On the one hand, such redistribution improves living standards of the poor and reduces income inequality. On the other hand, incentives to work may worsen. Determining if benefit levels are adequate is not straightforward and, in practical terms, is often investigated after benefit reform by estimating the effect of the reform on poverty or other metrics. There are, however, a number of more formal ways to determine the appropriate value of a social welfare payment. It can be benchmarked to a proportion of average wages; determined based on the replacement rate deemed necessary to smooth consumption or set using a Minimum Essential Standard of Living (MESL) method. The last benchmarking exercise was undertaken in Ireland in the context of Budget 2007. The Commission presents evidence that, since then, the real value of social welfare payments has fluctuated considerably. In our post-budget analysis last year, the ESRI suggested that a new benchmarking exercise would be a useful way of re-establishing the link between these payments and income adequacy.[5]

Work incentives

The tax-benefit system in Ireland is structured such that some households may be in receipt of multiple cash and non-cash benefits and pay tax. Examples of benefits which may be cumulated with other benefits/employment income include Medical Cards, National Childcare Scheme subsidies, housing and jobseekers supports. Many of these supports have different eligibility criteria and withdrawal methods. The withdrawal of one or more of these benefits simultaneously as income increases can reduce work incentives, especially if recipients also pay income tax or receive the Working Families Payment.

The Commission recommends reforming the primary working age payments so that there is one income-related working-age assistance payment available to all households. It suggests that this might be developed in tandem with another of their recommendations, a second tier of income-related child supports. This would expand and simplify the system of working-age supports while removing some of the complicated work disincentives.

The partially joint nature of the income tax system may also provide a disincentive for secondary earners (who are usually women) to join the labour market as, depending on the

[5] Doolan, M.; Doorley, K.; Regan, M. & Roantree, B. 2022. "Distributional impact of tax and welfare policies: Budget 2023", QEC Special Article

earnings level of the primary earner, the household may face a very high marginal tax rate on any earnings by the secondary earner. The European Commission's Work-Life Balance Package strongly recommends removing fiscal disincentives for secondary earners. A shift from the current hybrid system to full individual taxation, which would equalise the marginal tax rates of the primary and secondary earner, is a potential policy route to take from the perspective of increasing female labour supply and reducing gender disparities in the burden of household production in Ireland.

Universal Basic Income

The Commission reviews some of the evidence related to a Universal Basic Income (UBI) and recommends that such a policy should not be supported for Ireland. The ESRI has recently undertaken a substantial review of the potential advantages and disadvantages of a UBI policy, in addition to setting out a range of recommendation for the design of any future UBI pilot in Ireland. In terms of potential benefits, a UBI would avoid situations where people choose not to work in order to retain means-tested benefits. It could give individuals the freedom to turn down or leave insecure, exploitative or low-paid work in pursuit of better employment opportunities. Furthermore, persons in informal and often unpaid work, such as childcare and adult care, receive some compensation for their labour. In terms of potential disadvantages, a UBI may not target those that are most in need, as a large percentage of recipients will be high-earning individuals. Furthermore, a UBI is likely to be very expensive, even if other existing benefits (such as unemployment benefits) are no longer required. We estimate that the implementation of a UBI in Ireland in 2019 could have involved a gross cost of close to €50 billion per year. Finally, the net impacts of a UBI on labour supply are unclear.

Sustainability of the Social Insurance Fund

The Commission discusses the sustainability of the Social Insurance Fund (SIF). Re-iterating findings from the report of the Pensions Commission in 2021, it outlines the pressures that the fund is expected to come under in the short to medium term due to demographic change. It recommends a number of measures to broaden the PRSI base. These are in line with recommendations in previous chapters to improve horizontal equity in the tax and welfare system and remove cliff-edges but they would also increase the revenues of the SIF. In particular, the Commission recommends introducing PRSI for all earners and abolishing or minimizing exemptions based on age or income source. This is in line with previous ESRI analysis on broadening the tax base.[6]

Final remarks

We thank the committee for their time and the opportunity to discuss this important review and we look forward to answering related questions.

[6] Kakoulidou, T. & Roantree, B. 2021. "Options for raising tax revenue in Ireland", Budget Perspectives 202201