INTRODUCTION

"Taxation is either blatantly inefficient or unjust or both, in most of the world’s advanced countries". Some Statement! Not my words but the opening sentence of a recent leader in "The Economist".

Whether the tax system in Ireland is unjust or inequitable is a matter to be determined by government in the final analysis. However, I certainly do believe that the Irish tax system has many inefficient features and in this paper I hope to demonstrate this point. In particular, I propose to highlight the inefficiency of the tax system as it impacts on the employer/employee relationship and in the development of pay policy.

Growth of average tax rates 1975-1983
Table 1 demonstrates the growth in average tax rates in Ireland (including income tax and social welfare contributions but excluding Youth Employment levy) over the period 1975 to date for: a single person; a married couple with no children; and for a married couple with three children, (wife not working in both latter cases); a person on average industrial earnings, at 20 per cent and 50 per cent below average earnings; and those at twice average earnings. All this has been happening when, from an employer’s standpoint, pay levels and increases have been excessive relative to both productivity and labour market conditions. On the other hand, the employee has not been the beneficiary. Labour has become uncompetitive as a factor of production. Work for a wage has become less attractive. I will return to this point later in the paper.

Non-wage Labour Costs
Another feature of labour cost-development throughout the majority of OECD countries has been the more than proportionate rise in non-wage labour costs, especially since the first oil shock of 1973, reflecting pro-cyclical increases in employers’ contributions to social security and private insurance schemes. It is relevant to note that in several OECD countries the effects of greater wage moderation has increased the difference between the growth rates of real labour costs and productivity. In some countries, the real wage gap was narrowing while the real labour cost gap was rising.

Decline in Profit Share
An additional consequence of these developments in both wage and non-wage costs is that profit-share has declined significantly. This has contributed to the decline in rates of return on capital with adverse effects on new capital formation. These divergent movements of the real wage and the real labour cost gaps has had the following results:
wage-earners have become convinced that they have made sacrifices through real wage moderation and, at the same time, employers are seriously disturbed by the falling return on capital and profit shares. If this downward real wage adjustment had occurred in the absence of increases in tax there would have been a competitive gain equal to the competitive loss actually sustained.

**Lack of Coherent Policy**

Here in Ireland competitiveness of industry is affected not only by direct labour costs (such as wage costs) but also by indirect labour costs. Over the past number of years PRSI contributions have risen dramatically in absolute and, even more importantly, in relative terms. The percentage has jumped from about 4 per cent to 11.61 per cent in just over a decade. These spectacular increases were not the result of the implementation of any coherent policy. Rather they were due to a string of unrelated and unco-ordinated adjustments. A classic example of what political scientists call "disjointed incrementalism" and what less-polished observers might refer to as pure ad hocery. Thus, over the past few years we have seen:

1. The introduction of pay-related benefits,
2. The introduction of many new other social welfare benefits,
3. The extension of the period of short-time benefits,
4. A switch from flat rate contributions to a percentage contribution,
5. A large measure of indexation or indexation plus of benefits,
6. Dramatic increases in the threshold for contribution.

The result of all this is that the employer’s proportion of contribution to the social insurance fund will reach a figure of 55 per cent this year with the employee’s share less than half that figure at about 26 per cent. The proportion of the social insurance fund financed by the Exchequer will fall to an all-time low at about one-fifth of the total contribution.

**PRSI**

From an employer viewpoint the impact of these trends varies from firm to firm and from sector to sector. However, they tend to have the most immediate impact on the longer-established firms, particularly the labour cost-intensive firms. These trends in total labour cost-development act as a disincentive to those established companies considering expanding their activities. New industry firms as classified by the IDA have on average 25 per cent higher levels of productivity than the rest of industry and, consequently, on average are better able to cope, at least in the short-term, with the impact of these cost increases.

It is clear that a major element in their strategy for coping with these cost-increases is to keep down the numbers on their pay-roll to an absolute minimum. What employer is interested in paying a social welfare tax of over £1,000 a year on every person recruited at average industrial earnings or more? Clearly, this rate of cost-
### Average Tax Rates

#### Single

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>20% Below Average</td>
<td>20.4</td>
<td>20.0</td>
<td>20.0</td>
<td>19.8</td>
<td>25.8</td>
<td>23.9</td>
<td>24.9</td>
<td>25.3</td>
<td>26.9</td>
</tr>
<tr>
<td>50% Below Average</td>
<td>13.5</td>
<td>15.5</td>
<td>15.5</td>
<td>13.2</td>
<td>17.4</td>
<td>14.6</td>
<td>16.1</td>
<td>15.0</td>
<td>18.1</td>
</tr>
<tr>
<td>Average Earnings</td>
<td>25.01</td>
<td>19.67</td>
<td>23.27</td>
<td>22.87</td>
<td>28.71</td>
<td>27.03</td>
<td>27.91</td>
<td>29.31</td>
<td>33.9</td>
</tr>
<tr>
<td>20% Above Average</td>
<td>23.66</td>
<td>26.38</td>
<td>26.38</td>
<td>24.9</td>
<td>30.66</td>
<td>29.11</td>
<td>29.88</td>
<td>33.18</td>
<td>35.53</td>
</tr>
<tr>
<td>50% Above Average</td>
<td>25.93</td>
<td>28.71</td>
<td>28.71</td>
<td>27.28</td>
<td>33.85</td>
<td>32.25</td>
<td>33.52</td>
<td>38.38</td>
<td>40.32</td>
</tr>
<tr>
<td>Twice Average</td>
<td>28.2</td>
<td>32.25</td>
<td>32.25</td>
<td>30.7</td>
<td>38.95</td>
<td>37.02</td>
<td>38.85</td>
<td>43.94</td>
<td>48.6</td>
</tr>
</tbody>
</table>

####Married - No Children

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>50% Below Average</td>
<td>6.4</td>
<td>8.1</td>
<td>8.1</td>
<td>2.5</td>
<td>4.4</td>
<td>4.5</td>
<td>5.8</td>
<td>7.5</td>
<td>7.5</td>
</tr>
<tr>
<td>20% Below Average</td>
<td>14.1</td>
<td>15.2</td>
<td>15.2</td>
<td>10.5</td>
<td>13.4</td>
<td>13.2</td>
<td>14.8</td>
<td>14.8</td>
<td>16.6</td>
</tr>
<tr>
<td>Average + 20%</td>
<td>19.3</td>
<td>21.88</td>
<td>21.88</td>
<td>18.1</td>
<td>22.05</td>
<td>21.03</td>
<td>22.97</td>
<td>23.53</td>
<td>25.26</td>
</tr>
<tr>
<td>Average + 50%</td>
<td>22.44</td>
<td>25.08</td>
<td>25.08</td>
<td>21.48</td>
<td>25.03</td>
<td>24.38</td>
<td>26.13</td>
<td>26.93</td>
<td>27.76</td>
</tr>
<tr>
<td>Twice Average</td>
<td>25.58</td>
<td>28.75</td>
<td>28.75</td>
<td>26.46</td>
<td>30.45</td>
<td>27.03</td>
<td>28.35</td>
<td>30.44</td>
<td>31.85</td>
</tr>
</tbody>
</table>

####Married - 3 Children

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>50% Average</td>
<td>1.2</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
<td>4.4</td>
<td>4.5</td>
<td>4.75</td>
<td>7.5</td>
<td>8.5</td>
</tr>
<tr>
<td>80% Average</td>
<td>4.42</td>
<td>6.7</td>
<td>7.7</td>
<td>4.7</td>
<td>8.3</td>
<td>9.6</td>
<td>11.7</td>
<td>13.4</td>
<td>15.2</td>
</tr>
<tr>
<td>Average</td>
<td>8.93</td>
<td>10.07</td>
<td>11.03</td>
<td>8.57</td>
<td>13.2</td>
<td>13.6</td>
<td>16.15</td>
<td>18.18</td>
<td>20.9</td>
</tr>
<tr>
<td>Average + 20%</td>
<td>11.85</td>
<td>13.56</td>
<td>14.81</td>
<td>12.43</td>
<td>17.65</td>
<td>17.65</td>
<td>20.08</td>
<td>22.23</td>
<td>24.08</td>
</tr>
<tr>
<td>Average + 50%</td>
<td>15.46</td>
<td>18.37</td>
<td>18.85</td>
<td>16.96</td>
<td>21.3</td>
<td>21.68</td>
<td>23.82</td>
<td>25.89</td>
<td>26.81</td>
</tr>
<tr>
<td>Twice Average</td>
<td>20.34</td>
<td>23.4</td>
<td>23.13</td>
<td>20.88</td>
<td>26.6</td>
<td>25.01</td>
<td>26.61</td>
<td>29.44</td>
<td>33.0</td>
</tr>
</tbody>
</table>

* Includes income tax and social welfare contributions

** does not include Youth Employment levy
development is damaging to the environment for investment in Ireland. With such an unfavourable cost-development, it makes the task of those charged with attracting investment to Ireland all the more difficult. In its programm for government, the government recognised unemployment as its most urgent problem. It does seem perverse, therefore, for the government to place such a significant tax on employment in the form of PRSI. By contrast, the State offers a wide range of subsidies to business, mainly through the IDA and often in the form of cash grants, to aid capital development. One hopes that a reassessment of the somewhat contradictory nature of these policies will be reflected in the white paper on industrial policy, due to be published shortly. Clearly, the overall impact of these policies needs redirection towards giving all employers an incentive to employ.

Since 1979 when PRSI was fully introduced the maximum contribution by an employer for an employee has risen from £481 to £1,059 per annum. Even after allowing for inflation since then, the real maximum cost to an employer has risen by some 68 per cent. In the same period the maximum annual employee PRSI contribution has risen from £242 to £1,101. After following for inflation this is an increase of over 140 per cent. The situation has now been reached where many employees feel that largely because of the extent of the tax take the rewards for working have been eroded relative to the level of social welfare benefits. The black and informal economy has undoubtedly developed as a result and the morale and commitment of those at work has been seriously damaged.

Table 3: PRSI Contributions

<table>
<thead>
<tr>
<th>Year</th>
<th>Employer %</th>
<th>Employee %</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979 (1)</td>
<td>8.75</td>
<td>4.40</td>
<td>13.15</td>
</tr>
<tr>
<td>1980</td>
<td>9.8</td>
<td>4.50</td>
<td>14.40</td>
</tr>
<tr>
<td>1981</td>
<td>10.25 (2)</td>
<td>4.75</td>
<td>15.00</td>
</tr>
<tr>
<td>1982</td>
<td>11.61</td>
<td>7.50 (3)</td>
<td>19.11</td>
</tr>
<tr>
<td>1983</td>
<td>11.61 (4)</td>
<td>8.50 (5)</td>
<td>20.11</td>
</tr>
</tbody>
</table>

1. PRSI scheme first introduced in April 1979.
2. Includes 2 per cent increase in July 1981 but backdated to April 1981.
3. Includes 1 per cent youth employment levy.
4. At the same time the eligible income limit was raised from £9,500 to £13,000.
5. Includes special 1 per cent levy.
**High Marginal Tax Rates**
Failure to index the income tax bands and allowances has contributed both to a significant increase in the income tax burden and to the numbers of persons paying tax at above the standard rate. In the last tax year for which figures are available, 40 per cent of tax-payers, about 315,000, paid tax at rates above the standard 35 per cent. This compares with less than 6,000 sur-tax-payers ten years earlier. Contrast this position in Ireland with that in the United Kingdom where less than 5 per cent of the tax-payers are liable to tax at a rate in excess of the standard 35 per cent. These trends are causing serious economic damage. There are inflationary consequences in that persons paying higher marginal rates seek even larger increases in money incomes. Even the Irish Congress of Trade Unions has recognised this position and accepts that "apart from any other consideration, the present unfair system of taxation has a very negative effect on industrial relations in relation to pay expectations".

**Recruitment of Specialists**
In Ireland personal taxation has now become a constraint on the recruitment and retention of internationally-mobile specialist executives. The high rates of tax also constitute a formidable disincentive to initiative and hard work. The marginal rate of income tax has increased in recent years and is now 67 per cent (65 per cent plus Youth Employment levy plus income tax surcharge to which must be added a PRSI contribution of 6.5 per cent on a large part of earned income). This high rate operates above the relatively-low taxable income threshold of £10,000 for a single person or £20,000 for a married couple. In addition, recent years have also seen an existing personal allowances but of setting a lower figure. Dr de Buitleir argues that a reduction in mortgage interest tax allowances, the abolition of a residential property tax for higher-valued residences

While these changes in the taxation code have largely resulted from the requirements of the Exchequer for increased revenue to help bring the public finances into some balance, the net result of this litany of tax increases for employers has been to create a more difficult environment for the recruitment and retention of specialists in Ireland. The cost to companies of offsetting these disincentives so that the net equivalent salaries of internationally-mobile executives are not significantly eroded has increased dramatically.

**Labour Costs**
In the first half of this paper I have been dealing with the problems that have arisen from the scattered development of the tax and social welfare system. I have referred to the dichotomy of perception from the viewpoint of both the employer and the employee. We have had the growth in employer wage and non-wage costs on the one hand and, on the other, the extent of the tax take, its impact on the pay packet, and, finally, how the rate of tax growth impacts on the investment climate and the consequences for jobs. If the central objective of our national policy is to reduce unemployment, then the all-important objective in the medium-term must be to work towards a reduction in labour costs. We must recognise that some decisions on the tax front in recent years have in fact been putting people out of jobs and have in
turn resulted in a dramatic increase in the price of employing people and encouraged a switch to capital-deepening. Clearly this poses a challenge to government and, indeed, to those involved in the collective bargaining process. The co-ordination of budgetary policy, especially in the area of tax policy, on the one hand, and the activities of those involved in collective bargaining, on the other, will be the key element in the resolution of our present difficulties.

Role of Government

However, it must be recognised that the results of collective bargaining do have a very significant influence, some directly and some indirectly, on the whole working of the economy. In a country where the pay of the majority of the workforce is settled by collective bargaining, this leaves government with no choice but to seek to influence the decisions taken by those at the bargaining table, if they are to influence the eventual pay settlement. Government must adopt the difficult role of policy-shaper and co-ordinator in implementation. Only through acceptance of these responsibilities can governments ensure the greatest degree of cohesion and seek to satisfy the economic, social and political aspirations of the electorate.

In its approach to incomes policy, governments must accept that real income is a concept that, not only relates to pay and prices, but also takes into account tax and social welfare changes and the benefits households receive under welfare schemes. While fiscal decisions of this character are not taken by the collective bargainers, their decisions are and can be considerably influenced by the fiscal and welfare policies of a government. In this context information made available by government, say, by way of a white paper, should be sufficiently detailed to enable collective bargainers to reach agreements explicitly with the levels of taxes and welfare payments in mind. Through the right mix of tax and social welfare policies, a government can make it possible for those involved in collective bargaining to arrive at pay settlements that accord with government overall economic and social objectives. Anything less than the structure of a formal policy will fall flat on its face while mere exhortation, even from government, is unlikely to be effective.

I have little doubt that if the approach suggested is adopted there is some trade-off for trade unions between gross pay increases and net tax and changes in social welfare, wherein the government can propose, on a conditional basis, some alleviation of the tax burden or improvement in social welfare benefits or a combination of both. It is crucial that the initial lead is given by government. The government must accept responsibility both for initiating and co-ordinating national negotiations and for making its own contribution to national bargaining in its capacity as employer and manager of the national finances. A voluntary procedure has the best chance of success and can be better adapted to mobilising the forces of public opinion in support of a national policy. However, in the last resort, the government may have to take a more stringent unilateral approach on the question of prices and incomes generally.
Conclusion

It must be clear to all that the obvious lack of accord and coherence between the conduct and outcome of the development of tax policies on the one hand and collective bargaining on the other, have had very unpleasant consequences. The negative results flowing from unco-ordinated approaches are all too clear. While the primary role in redressing these effects rests with government, employers and unions must have regard to the role of government and must feel its presence. In the final analysis, if we do not adopt a more structured and co-ordinated approach in the development of pay, tax and social welfare policies, then stability and prosperity will continue to elude us.
DISCUSSION

S. Cromien. I should like to welcome you, Mr. President, since this is your first time to preside at a meeting of this august society. You are, I know, doubly welcome as a member of our Northern Branch.

The three papers we have listened to this evening have been very stimulating and have provided an excellent background to our discussion. The variation in emphasis between the three speakers is instructive and is characteristic of the debate which has been taking place in recent years on taxation. Different people have very different views of what should be done to remedy the causes of the present discontents. Perhaps the only thing on which there is general agreement is that the burden of personal taxation is too high. This is of course not a novel view. In 1853 when Gladstone was asking in the House of Commons for a prolongation of the income tax he said that he planned it should stand at sevenpence in the pound for two years: at sixpence for two years after that and at threepence for three further years. In 1860 he hoped it would be dispensed with altogether. He explained that in his view income tax was, in its essence, immoral. It tempted statesmen to extravagance; it tempted the taxpayer to practise fraudulent evasion "which it would not be possible to characterise in terms too strong".

I should like to concentrate my remarks on Dr. de Buitleir's paper because of the interesting issues which it raises. It would be inappropriate for me as a senior civil servant to comment on the policy matters which arise in the report of the Commission on Taxation but I can, I think, make some comments on the figures in his paper.

A key proposal of the Commission is that income tax should be charged at a single rate on all income. The Commission did not specify a rate (although in a footnote on page 457 of the report an illustrative figure of 25 per cent was mentioned, to which 5 per cent social security tax was to be added). They made it clear, however, that they felt that their proposals should lead to a rate below the current standard rate of 35 per cent for the vast majority of taxpayers. The appendix to Dr. de Buitleir's paper shows how in his view the direct tax system in 1983/84 could be converted to a flat rate of 35 per cent with only a small loss of revenue (£50m.), which could be made up in indirect taxation. We in the Department of Finance and our colleagues in the Revenue Commissioners have examined these figures and are satisfied that they are unrealistic. They are based on an over-optimistic approach to revenue estimation which we feel is unjustified and will, in our opinion, increase the burden on the lower income group.

In the first place the conversion of tax credits is done on the basis not of retaining the existing personal allowances but of setting a lower figure. Dr de Buitleir argues that with high rates of PRSI it is not necessary, once you are ameliorating the PRSI position, to take the exact equivalent of existing allowances. However, unless you do so, a large number of people will lose. We feel he has underestimated the cost of this item to the extent of over £200m. As he acknowledges in the Appendix, Revenue,
and we in Finance agree with them, do not accept that introducing indexation arrangements for the corporation tax and schedule D taxpayers would not involve a loss of revenue. It is realistic to expect that this arrangement would immediately produce a loss of revenue and in our view a very substantial one.

I cannot comment on the policy implications of the next point but I should at least like to draw your attention to his assumption that the introduction of a social security tax for the self-employed and public servants would not necessitate an extension of benefits to these categories. If he is wrong in his assumption, this could cost hundreds of millions of pounds extra. When we make what we consider a realistic assessment of the possibilities, we are satisfied that introduction of the Commission's scheme in 1983/84 would have resulted in a flat rate of the order of 40 per cent for taxpayers.

Even on Dr de Buitleir's figures, we must ask about his scheme _cui bono_? You will note that the extension of the tax base as described in Table 8, includes a figure of £802m or 50 per cent of the total for taxing short term social welfare benefits and getting rid of the exemption limits. Whatever about the merits or demerits of these proposals, it is clear that taxpayers at the lower end of the scale would be affected. If, as we say, the flat rate increase works out at 40 per cent rather than 35 per cent the effect on many less well-off taxpayers would be greatly increased. In this connection, I note Mr Sweeney's comment on page 15 of his paper that the Commission's proposals would probably result in a redistribution within the PAYE sector rather than between it and other sectors.

The Minister for Finance in the last budget, in congratulating the Commission for their work, pointed out that,

"Fundamental to the Government's approach to the proposals of the Commission, no matter how well-founded these may otherwise be, must be the maintenance of an adequate tax revenue yield. Otherwise, our public finances would be in a disarray."

The costing of the Commission's proposals is, therefore, a critical factor. This costing shows that a combined single rate of income tax and social security tax levied on all personal and corporate income at a relatively low level, as envisaged by the Commission, is not a practical proposition at this time because of the loss to the Exchequer. This loss could be made good only by introducing the single rate at a level which would be unacceptably high for the majority of taxpayers. In these circumstances, action towards implementing the main thrust of the Commission's proposals cannot be undertaken for the time being at least."

Dr de Buitleir very rightly says that if the Commission's proposals are rejected alternative proposals should be put on the table. I would not like my remarks to be taken as a rejection of the principles in the Report. This is a matter for the Government to decide. If the Exchequer position were different, and substantial
revenues could be directed to reducing the general burden of personal taxation, the Commission's recommendations could certainly be one road to follow. There could also be others, depending on the acceptability to the community of the effects of the Commission's schemes and other schemes.

At the end of the day, this is the question that has to be answered in a democracy, in order to remedy the defects in the present system, are the changes recommended broadly acceptable to the community? It is true that there is much to be said for simplification of the tax system. However, as G.K. Chesterton pointed out, simplification is not always the answer: in a shop selling women's hats, the shopkeeper can always simplify by keeping only one size of hat and only one fashion. This will, however, neither satisfy the needs of, nor please, the customers. A tax system is in some ways similar. It has multiple objectives and it is difficult to devise a single arrangement which will meet its many needs.

I should like to thank the three speakers again for their excellent and thought-provoking papers.

M. Hederman-O'Brien: I particularly welcome the contribution of Mr. Sean Cromien to this debate since it gives the Commission an idea of the views of the Department of Finance. The challenge to Dr. de Buitreir's paper I will leave to him to answer but there are two general issues on which I would like to comment. First is Mr. Cromien's dismissal of the simplicity advocated by the Commission. Since there have been criticisms, particularly of the progressive expenditure tax, on the grounds of complexity I am surprised at his use of the Chestertonian analogy. I would consider that such criticisms are misplaced, since the expenditure tax advocated is different rather than more complicated than several of our existing taxes. However, I see no conflict in a system which would be simple, straightforward and efficient for the vast majority of taxpayers and complex and effective for the small minority who are already in the arena of sophisticated financial transactions. The existing tax system is so complicated that it is manifestly unfair to those who cannot afford expert accountancy advice and it has placed an enormous and wasteful burden on both individuals and enterprises who have to comply with its provisions. Furthermore, the present complicated tax system feeds dissatisfaction with the base on which it rests, because people feel, with justification, that it makes inequity and the misallocation of resources.

As far as the redistributive effect of the Commission's proposals is concerned, I would like to repeat that this is a political decision which must be taken by government. It depends among other things on the size of personal credits and the level of the single rate. I suspect that the figures produced do not take account of the fact that persons on low incomes benefit much less from deductions from income than those with higher incomes. Since lower income groups do not qualify for mortgages they cannot avail of mortgage relief. Since lower income groups do not have disposable income to invest in life assurance, that relief, too, is not relevant to them. They may have some VHI relief as part of a group scheme but it is likely to be minimal. The Commission considers that when government decides the level of
income at which tax should be paid that the manner in which this income accrues should be irrelevant for tax purposes. If it is undesirable that those on social welfare should be taxed, why should lower paid workers in the same circumstances and with the same income bear tax? It is not correct to say, as Mr. Cromien has done, that the Commission's proposals benefit any particular income group. The Commission went to great pains to ensure that the package was flexible enough to accommodate a wide range of political views on income distribution. Those who enjoy substantial allowances under the existing system may well pay more tax under our proposals. Those whose income is now fully taxed will pay less. The level of tax and the stage at which it becomes due is a decision which rests with government. I would question whether, in these difficult times, the community can afford the waste generated by the complexities and anomalies of the existing system.

The comment and criticisms of those who have spoken tonight will be of interest and, I hope, help to the Commission in its work on the remaining reports.

_L. Smith:_ I am subject to PAYE but have examined the tax position of the self-employed. I have no doubt that the PAYE position is preferable:

a) The uncertainty of liability is a business hazard.
b) The tax allowance being £600 lower for each family member, makes the tax heavier.
c) Research carried out by Dr. Frank O'Brien and L. Smith, soon to be published the _Accountant_, shows the compliance costs often heavier than the tax collected.

The fact is that tax is too high in general. The comparison of average tax rates in various countries quoted by Mr. Sweeney are not relevant when GDP per head is so much lower in Ireland. For comparable incomes our taxes, which are a cost to industry, are much higher. Consequently no employer in highly paid, labour intensive, industry will come to Ireland. Such footloose activities, and their workers, will settle in lower tax areas. It is idle to try to attract much Research and Development, for example. European countries in general are made uncompetitive and rigid in comparison with actively developing countries. Talk of even higher taxation is not prudent. The talk of adding a new and high tax on capital is irresponsible. Such taxes are not heavy in other countries. If the Government wishes to kill the goose that lays golden eggs they may act unexpectedly and get a once-off feed of goose. If they frighten the goose they get neither goose nor eggs.

_P. Honohan:_ The papers and discussion tonight have been concerned mainly with two aspects of taxation - revenue and equity. Without minimising the importance of these criteria for assessing tax systems, we should not neglect a third criterion. This is what the economics textbooks call efficiency, and indeed these textbooks typically devote more pages to efficiency than to questions of equity and revenue raising ability together. Put briefly, the question of efficiency arises because taxation typically distorts the relative prices facing economic agents. Some such distortions have been mentioned in the discussion, at least implicitly. These have
primarily concerned distortions which lower the demand for labour or reduce the incentive to invest in productive capital equipment. I believe that such distortions are quite severe at present.

A much neglected consideration is the way in which complex tax structure can alter patterns of private expenditure in wholly unintended ways. When indirect tax rates on most commodities were low, such distortions were not very great. But at today's VAT rates, the exemption of certain items from the tax base and the subsidisation of other items have substantially altered relative prices. The resulting expenditure patterns may be expected to yield loss overall welfare than could be obtained from a less arbitrarily distorted structure of relative prices even at the same average tax rate.

**J.A. Bristow:** I believe that tax legislation should be consistent with horizontal equity because I do not like laws which make what appear to me irrelevant distinctions between citizens. So, I should support the general thrust of the First Report of the Commission on taxation in its efforts to apply the principles of comprehensive income taxation. Regardless of the ultimate incidence of a comprehensive income tax, such a tax deserves support because then the law treats equals equally. However, much of the current concern over taxation centres on how the tax system affects the relative disposable income of different groups in society (the rich versus the poor, employees versus owners of firms, farmers versus everyone else, and so on). The effect of the system on relative disposable incomes (the economic incidence) will be revealed by an examination of the tax laws, which shows the statutory incidence, only if one assumes that the sole response anyone makes to a tax is to pay it.

Most of those who are publicly vocal about taxes apply this assumption inconsistently. For example, they assume it to be true as regards PAYE income tax or social welfare contributions but assume it to be untrue with regard to VAT or excises (i.e. they assume that workers merely pay their income taxes or PRSI, whereas shopkeepers do not pay the VAT levied on them but put their prices up). But even casual observation of the way tax matters have been brought into pay bargaining suggests that the assumption is untrue as regards PAYE. Workers demand, and get, higher gross pay than they would if income tax on wages were lighter. So, the effect on their disposable income is less than would be suggested by the application of nominal tax rates to given gross wages. Similarly, if employers' social welfare contributions were reduced, employers could pay higher wages (or increase employment) without reducing their profits. Thus, the effect of these contributions is to depress wages (and, perhaps, employment) and so the burden rests, at least partially, on workers rather than employers.

Until we know how people respond behaviourally to taxes we cannot know, for example, how progressive even one tax is, let alone how progressive the total system is. Appeals to statutory incidence are simply irrelevant and so are appeals to documents like the recent CSO study on *Redistributive Effects of State Taxes and Benefits*. This study assumed, inter alia, that income taxes were not shifted at all and that indirect taxes were totally shifted forward. Such assumptions are not derivable.
either from standard economic theory or from any evidence of which I am aware. We would be better simply to admit our ignorance.

P.J. Clarke: I would like to preface my remarks by adding to the historical dimension referred to by a previous speaker. It is interesting to note that in 1874, Gladstone called a general election and promised to abolish income tax if returned to office. He was defeated and was later reported to have said that that would be the last chance the British people would have to abolish income tax.

Turning to the main point of to-night's discussion, I feel that the principal limitation of this discussion is that it focusses only on the taxes which people pay to government. No speaker has touched on the negative taxation side which is the benefits which taxpayers receive from government expenditure. I feel that the tax system should be looked at as a whole, representing the totality of the non-commercial transactions between the individual and the state. Until the individual benefit side of taxation is introduced into the analysis, discussions such as this will be indeterminate.

A second point is that discussion on tax reform must take note of the present serious state of the Exchequer's finances. For 1983, the current budget deficit is projected at approximately £1000m which represents a considerable deficit of day-to-day spending over incomes. At present there is approximately one million income taxpayers which means that additional taxation of £1000 needs to be imposed on each existing taxpayer just to eliminate the current deficit. Consequently, I believe that tax reform should be discussed in the context of the nation's finances and should not be allowed to (unintentionally) obscure the stark reality with which this country is faced.

Discussions like this inevitably make reference to the perceived inequitable distribution of the tax burden among various groups in society. Chiefly the farming community is depicted as making inadequate contributions to the Exchequer. I do not want to get involved in this particular point. Rather, I should like to ask a question which I have asked elsewhere, but which has never been properly answered. Why are farmers not entitled to the 10 per cent manufacturing rate on profits just like companies? Crop growing, cattle rearing etc. could easily be classified as manufacturing industries and therefore profits would be taxed at 10 per cent. I feel that such a proposal would eliminate the basis for a great deal of antagonism which currently exists in Irish society.

This brings me to my final point. I believe that the main problem with the Irish taxation system is that there is a great deal of perceived inequity with the tax system. For example, the PAYE taxpayers perceive that they are paying an inequitable portion of the tax burden relative to the self-employed and farming community. This perception may be correct or incorrect but the perception exists and should be addressed. If this perception is allowed to fester it can only lead to greater levels of tax resistance and non-compliance. If this widely held perception is in fact wrong, then it is government's task to change peoples' attitudes. On the other hand, if this
perception is correct then it is government's task to change both reality and perceived reality

_E. Fitzgerald:_ Any proposals for reform of the tax system must be judged on their redistributive effects - who gains and who loses. The absence of any analysis on these lines was a major drawback in the First Report of the Commission on Taxation, and I am sorry to see it absent once again from Dr. de Buitleir's paper here tonight. Indeed he states in his paper "It is not possible to say whether the Commission's proposals favour any particular income group". This should surely be the central focus of any tax reform proposals. are they progressive or are they regressive?

If Sean Cromien is correct in his figures indicating that the Commission's proposals in 1983/84 would require a 40 per cent tax rate, surely the total package must be seen as regressive. Taxpayers paying at marginal rates of 25 per cent and 35 per cent as well as the zero-rated group under the tax exemption limit, would see their tax rates rise to 40 per cent, while the 45 per cent, 55 per cent and 65 per cent bands would see their tax rates drop, to some extent offset by having their tax allowances converted to tax credits. The major extensions to the income tax base come from the dropping of exemption limits and the taxation of short term social welfare benefits (see appendix table 'Income tax base 1983-84') and from abolishing the income tax allowances for PAYE and PRSI. Excluding personal allowances, which reappear converted into tax credits, these three factors account for well over half the extension of the tax base, with a relatively small contribution coming from the abolition of interest relief, VHI relief etc.

I agree completely with the Commission's arguments for abolishing the tax-deductibility of such expenditures. But while this seems to have been publicly hailed as the major contributor to the expanded tax base, in fact the major contribution comes from lowering the level of personal allowance/tax credits, from abolishing exemption limits, and from taxing short-term social welfare benefits. The single credit proposed is £385. The present tax allowance for a single person is £1450 plus PAYE allowance of £600, plus PRSI allowance of £286 equivalent to a tax credit of £817 for the taxpayer on a marginal rate of 35 per cent and more above that. A single person earning £4,000 on PAYE pays £340 a year PRSI etc and £482.40 income tax, a total of £822.40 a year. Under Dr. de Buitleir's scheme, he would pay tax at 35 per cent (to include PRSI) less the credit, a net £1015 a year. A married PAYE worker pays tax and PRSI at present totalling £1520 a year on an income of £7,000. Under Dr. de Buitleir's proposals, he would pay combined tax-PRSI net of £1815 a year. A single man who is out of work at present gets £34.80 per week in basic unemployment benefit. Only half the unemployed receive any pay-related supplement. I believe that while many of us would argue that where someone is working intermittently throughout the tax year, both social welfare and earnings should be aggregated for the purpose of the tax assessment, it is generally held that any system of taxation of social welfare benefits should not involve a net loss of income to those whose only income at present is the basic social welfare payment. A single person drawing unemployment benefit at the basic rate and with no other
income receives an annual income of £1810. At present such a person would not be liable to income tax or PRSI. Under Dr de Buitleir's proposals, he would not pay net annual tax of £248.50 or about £5 a week. This would be completely unacceptable, to levy in the name of tax equity an extra £5 a week from those on subsistence social welfare incomes.

The proposed abolition of tax exemptions for low-paid workers, and the taxation of short-term welfare benefits, on the lines above, together account for £802m. of the broadened tax base in the appendix, Table 1. The tax yield however, if the taxation of short-term welfare benefits were confined to those with additional incomes, would be more like £10m. only.

The other main sum comes from abolishing exemption limits. In fact these exemptions are a particularly effective way of concentrating tax reliefs on the lower paid without increasing tax allowances or tax bands all round. The increased tax take from single people under £2,400 and married couple under £4,800 would be substantial under the proposals as designed.

It is clear that the effect of the proposals would be to substantially increase the tax burden of the lower end of the income scale if the suggested rates and credits in the paper were the ones adopted. At the other end of the scale, let us look at a single PAYE worker earning £15,000. At present between tax and PRSI he pays £7316 a year. Under the new proposals he would pay only £4865. Even if he is claiming full tax relief on a mortgage at present, the direction of the saving remains the same - he pays tax of £4865 in lieu of £5631 today.

The net conclusion from these examples must be that the illustrative credits and tax rates proposed clearly involve a benefit to those up the income scale at the expense of those on subsistence social welfare incomes and on low pay. The abolition of tax deductible expenditures blunts this picture to some degree, but the main money is found by taking more off those on lower incomes through lower effective tax credits in order to fund a reduction in income tax rates higher up the scale. Higher tax credits could produce a more acceptable redistributive picture at a single rate of tax. But it would be a very much higher tax rate. I believe that in present circumstances the goal of a single rate of tax is incompatible with the pursuit of tax equity in the sense of a better redistribution of income to those lower down the income scale.

One final point. It is argued by the Commission, without any econometric evidence as to the actual incidence, that employer's social insurance contributions are passed on in higher prices, consequently it is argued in the paper that £400m could be transferred from employer's PRSI and VAT without raising prices - only in this way can the income tax rate be kept down to 35 per cent. I think it would be difficult to convince the Department of Finance that £400m could be raised in VAT in this way without raising prices. Indeed if all the employer's PRSI is passed on in prices, there would be no increase in employment from abolishing it.

Finally, I would like to thank the three speakers for their thought-provoking papers.
No doubt the controversy on these issues will run and run

Reply by Dr. de Buitleir: I am very grateful to the speakers for their contributions which are very interesting. I will try and deal with the points that have been raised.

Firstly, I agree with much of what has been said particularly about

(i) the importance of the incidence of taxation and the great uncertainty which surrounds it, mentioned by Professor Brustow;

(ii) the very serious distortions arising from the present system stressed by Dr Honohan, and

(iii) the importance of looking at the redistributive effect of taxes and benefits raised by Mr. Clarke. This was stressed both by the Commission and in its report. However, the CSO study is wholly inadequate as a means of assessing this due to the unrealistic assumptions about the incidence of certain taxes and benefits upon which it is based.

Mr. Cromien has said that the figures in my paper are unrealistic. I am quite prepared to believe that they are since I got them from the Revenue Commissioners! To be serious, there is no disagreement on the figures except in the case of the inflation adjustments proposed by the Commission. The plain fact is I do not know if I am right and the Revenue Commissioners do not know either - the data are simply not available. However, I believe that the Revenue Commissioners are being unduly cautious. The basis on which my estimates are made are in the Appendix to the paper. All I suggest is that you read it and make up your own minds.

Mr. Cromien and Councillor Fitzgerald have argued that the Commission's proposals will hit the poorer sections of the Community. Two points need to be made. Firstly, the Commission proposed a tax system which can be implemented in a flexible way. Different combinations of tax credits and rates produce widely different income distribution effects. When we examined possible effects within the Commission, we found that no generalisations were possible. Those who do well under the existing system lose and those who do badly, because their income accrues in a form which is taxable and have little or no deductions, gain. Secondly, it is very important to acknowledge the potential of public expenditure to achieve desirable income distribution effects. The tax changes proposed will not occur in a vacuum. Thirdly, as regards the lower income group, the tax credits of £385 and £770 allow the complete abolishment of the employer's social insurance contribution. Some account must be taken of the effect of lower prices resulting from this in looking at the position of the lower and indeed all income groups. Mr. Cromien and Councillor Fitzgerald have totally ignored this in their comments. If they are right and I am wrong we can all become richer by abolishing all taxes and replacing them by employers' social insurance contributions which are paid by nobody! Fourthly, Councillor Fitzgerald argues that a major part of the extension of the tax base comes from abolishing exemption limits and taxing short-term social welfare benefits. This amounts to income of £802 million. However, I have excluded most of this again.
when estimating the cost of credits The extra cost of credits given to taxpayers who are not now liable to tax is £267 5 million, an income equivalent of £764 million. On this basis, the yield from taxing social welfare benefits might be of the order of £13 million There is no major difference between Councillor Fitzgerald and me on this point.

However, I cannot accept her view that if employers’ PRSI is fully shifted into prices, there is no effect on Irish employment If PRSI were replaced with a neutral tax on consumption, the prices of Irish goods and services would fall relative to foreign goods and services and within that the price of labour-intensive goods and services would fall relative to capital-intensive items The strength of the demand response to this is a matter for debate, but there can be no doubting its direction, employment in Ireland must increase as a result.

1. First Report of Commission “The Key Elements of Proposed Reforms” paragraphs 29 and 30


P. Sweeney: I would fully agree with the point made by Councillor Fitzgerald, which is that the redistributive effects of any proposed tax system are of vital importance. This, of course, has implications for efficiency, as Dr Honohan points out, but I feel not enough attention is given in Ireland to the tax system as a mechanism of redistribution of income or wealth Ms. Fitzgerald’s example, which illustrates the comparative position of a person at present on social welfare and then under what is believed to be known of the Commission’s proposals, is disturbing, because this person’s position would be made worse Similarly, the examples of the high and low income earners under the present and proposed systems, indicate that the present system would actually be less regressive than that proposed, if the assumptions are correct. Therefore, it is of vital importance that the tax credit be set at a substantially higher level than that implied and that there should be more than one rate of tax.

Professor Smith makes the point that it is tax on GDP per head which is important and I think that this emphasises my point that as income per capita is lower here than in other European countries, then the tax base must be expanded. Our high dependency ratio, rapidly growing labour force, the very small tax contribution by a large section of the labour force, the farmers, from the corporate sector, and from capital, means that the burden on those who pay is too high, relatively. In regard to Professor Smith’s other point which argues against higher taxes on capital, and therefore against a more equitable tax system, I believe that there should be more capital taxation, and I do not believe that this endangers the golden eggs at all, because the goose is highly infertile, as 250,000 unemployed testifies.

I agree with Professor Bristow that workers attempt to get higher gross pay to compensate for lower net pay because of tax increases. However, as I have
mentioned above, they have not been successful in doing so in recent years. At the same time, most workers are aware that tax has to be paid, even though it does of course, depress wages. Similarly, I would regard employers' PRSI as a levy which, in general, is incurred by employers, but it is part of the social wage, as it is paid into the social welfare fund. If it is reduced, then it is equivalent to a cut in workers' wages.

All in all, the problem of formal versus effective incidence of taxation is an old one which was discussed by 19th Century economists, including J.S. Mill. More recently, economists such as King, 1 have argued that a general equilibrium model of the economy would be required to provide answers to questions about incidence. In the absence of such a model, one must use common sense in attempts to analyse the incidence of tax. Therefore, the formal or statutory incidence of a tax is as good a starting point as any. However, one must then consider issues such as market structure (the existence of monopolies, closely competing goods, firms, imports, etc.). Secondly, price elasticity, both of supply and of demand, i.e., responsiveness of factors of production, outputs and inputs, to changes in price, must also be taken into account. Under these circumstances the question of incidence remains somewhat subjective and open to debate. Therefore, statutory incidence is as good as any for an examination of a tax.