A FAIRER TAX SYSTEM FOR A FAIRER IRELAND

CORI Justice Commission

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Edited by
Brigid Reynolds, s.m. and Seán Healy, s.m.a.

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e-mail: justice@cori.ie

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AIB Investment House,
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CONTRIBUTORS

Tim Callan	is a Research Professor at the Economic and Social Research Institute
Micheál Collins	lectures in the Department of Economics, Trinity College, Dublin and is a researcher at the Urban Institute Ireland..
Richard Douthwaite	is an economist, author and economic adviser to the Global Commons Institute (London).
Tom Dunne	is a chartered surveyor and head of the School of Real Estate and Construction Economics in the Dublin Institute of Technology
Seán Healy	is Director of CORI Justice Commission
Emer Ó Siochrú	is a Planning and Development Consultant
Colm Rapple	is a journalist and author
Brigid Reynolds	is Director of CORI Justice Commission

INTRODUCTION

Policy formulation is based on a vision of what it to be achieved. In recent times the importance of building a fairer Ireland has been highlighted in a range of different arenas. Taxation policy is particularly important in this context since its outcomes have a major influence on the shape of society. It is crucial that the tax system be fair and seen to be fair. Crucial questions arise. What should Ireland's total tax-take be if it is to pay for infrastructure and social provision? Can Ireland afford this level of taxation? What should the tax base be?

The chapters in this book, which were first presented at a policy conference on this topic, focus on what needs to be done to move towards a fairer tax system for a fairer Ireland. They provide a comprehensive analysis of the present tax system and situate it within the wider international context. They analyse the issues that must be addressed if the tax-base is to be expanded. They also look at how social inclusion could be promoted through the tax system. They also provide a range of guiding principles that should underpin the choices made in taxation policy. They spell out the choices that must be made if Ireland is to have a fairer future for all its people.

In presenting this volume on *A Fairer Tax System for a Fairer Ireland* we do not attempt to cover all the questions that arise around this topic. This volume is offered as a contribution to the ongoing public debate around these and related issues.

The CORI Justice Commission expresses its deep gratitude to the authors of the various chapters that follow. They contributed long hours and their obvious talent to preparing these chapters.

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Brigid Reynolds
Seán Healy
October 20th, 2004

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1

TAXATION IN IRELAND: AN OVERVIEW

1

TAXATION IN IRELAND: AN OVERVIEW

Micheál L Collins

Introduction

This chapter serves as an introduction to the current nature of taxation in Ireland. Its intention is to review Ireland's relative position to that of other European countries and to consider whether it is necessary that changes should occur to Ireland's tax burden.

The structure of the chapter is as follows. The first section reviews the most recent data available on the scale and composition of taxation in Ireland and Europe. Following it, the chapter considers whether there is a need for change in Irish taxation levels and if so when does that change need to occur. The penultimate section addresses a number of issues surrounding changes to the tax burden including economic growth and competitiveness. Finally the chapter provides a conclusion.

The Tax Burden and Structure

The most up-to-date figures on the size of the Irish tax burden have been produced by Eurostat (2004a) in a publication entitled *Structures of the Taxation System in the European Union, 1995-2002*. Given the recent expansion of the European Union, their report provides previously unavailable data on the taxation structures of the 10 new accession states alongside continuing to provide annual harmonised data for the 'older' 15 members. As such, the publication allows for the first time the examination of taxation levels across all 25 EU member states. The definition of taxation employed in the report incorporates all compulsory payments to central government (direct and indirect) alongside social security contributions (employee and employer) and the tax receipts of local authorities.[1] Eurostat employ the same definition to all 25 states thereby ensuring that the resulting data are comparable.

The tax burden of each country is established by calculating the ratio of total taxation revenue to gross domestic product (GDP). Table 1 provides these tax/GDP ratios and ranks EU member states by the size of their tax burden in 2002.

Of the 25 member states, the highest tax ratios can be found in Sweden, Denmark, Belgium and Finland while the lowest appear in Ireland, Lithuania, Malta and Latvia. Overall, Ireland possesses the lowest tax burden at 28.6 per cent. Across the period from 1995-2002 the Irish tax burden has fallen 4.8 percentage points from 33.4 per cent (Eurostat, 2004a:239). In 2002 the Irish tax burden was 7.2 per cent lower than that of the UK, 10.9 per cent below than that of the Netherlands and 15.6 per cent lower that the tax burden of France.

[1] See Eurostat (2004a: 32-34) for a more comprehensive explanation of this classification.

Table 1: Total tax revenue as a % of GDP, for the 25 EU countries in 2002

Country	% of GDP	Country	% of GDP
Sweden	50.6	Portugal	36.3
Denmark	48.9	Greece	36.2
Belgium	46.6	Spain	36.2
Finland	45.9	United Kingdom	35.8
Austria	44.4	Czech Republic	35.4
France	44.2	Estonia	35.2
Luxembourg	41.9	Slovakia	33.0
Italy	41.7	Cyprus	32.5
Germany	40.2	Latvia	31.3
Slovenia	39.8	Malta	31.3
Netherlands	39.5	Lithuania	28.8
Poland	39.1	**IRELAND**	**28.6**
Hungary	38.8	EU Average*	38.5

Source: Eurostat, 2004a:239.
Note: * This is the unweighted EU average figure.

From an international perspective the Irish taxation burden is also seen as very low. Tax burden data for the 30 member countries of the OECD show that only three developed world countries possess a lower tax take. These are Mexico, Japan and Korea. Furthermore a comparison between Ireland and the United States, traditionally seen as a very low tax economy, reveals that the US tax burden was higher at 28.9 per cent of GDP. Across the 30 OECD countries the average tax burden equalled 36.9 per cent (OECD, 2003:18).

The appropriateness of using GDP as the benchmark against which tax levels are measure is the accepted international procedure. However, in Ireland some suggestions have been made to the effect that gross national product (GNP) should be the measure used. This argument is based on the fact that Ireland's large multinational sector is responsible for significant profit outflows which if counted (as they are in GDP but not in GNP) exaggerate the scale of Irish economic activity.[2] While it is clear that multinational profit flows create a considerable gap between GNP and GDP, it remains questionable as to why a large chunk of economic activity occurring within the state should be overlooked when assessing its tax burden. As GDP captures all of the economic activity happening domestically, it only seems logical, if not obvious, that a nations taxation should be based on that activity. The fact that the structure of that tax base is such that some of the revenue generated will eventually flow abroad is surely incidental. Commenting on this debate in a recent book, Bristow concluded that "it is not at all clear why anyone should claim that GNP is the more appropriate measure of taxable capacity. It is universal practice for countries to tax income generated domestically, regardless of the residence of the recipient. Thus, profits generated in Ireland are taxable in Ireland, even if they are subsequently repatriated abroad. Such repatriated profits, part of GDP but not GNP, are legitimately part of Ireland's tax base. So, there are good reasons for comparing tax/GDP ratios when judging whether a country effectively taps into its potential tax base" (Bristow, 2004:2).[3]

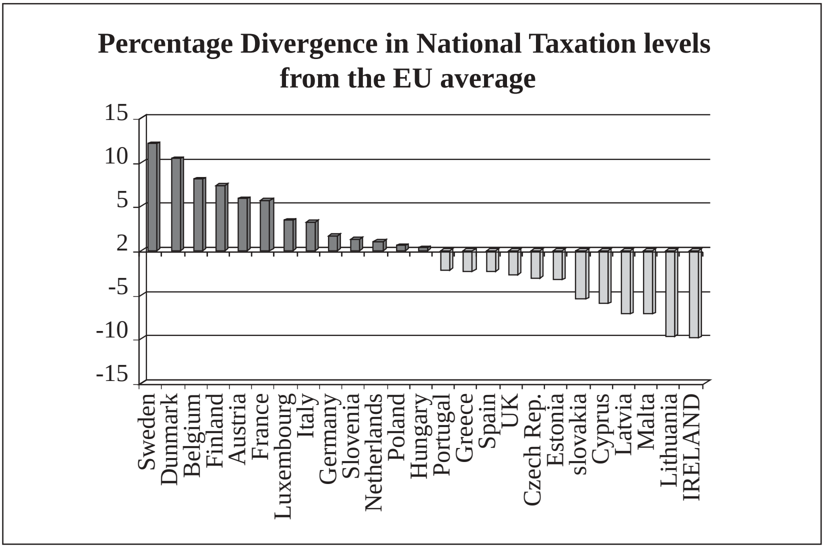
Chart 1 continued the analysis presented in table 1 by comparing the divergence in taxation levels across the European Union from the EU average (38.5 per cent of GDP). With a ratio of 28.6 per cent Ireland has a tax burden almost 10 per cent below the EU-25 average. The data in table 1 and chart 1 also reflect the fact that many of the new accession states possess low-tax burdens with their average figure being 34.5 per cent compared to 41.1 per cent for the 15 older member states.

[2] This is a uniquely Irish debate and not one that features in other OECD states such as New Zealand where noticeable differences between GDP and GNP also occur.

[3] The use of GNP rather than GDP is therefore likely to overstate the size of the tax burden. While it is clear to this author that GDP is the most appropriate indicator on which to assess the tax base, the 2002 tax/GNP ratio for Ireland was calculated as 35.0 per cent (calculated using national income data from CSO, 2004a:4). In spite of the methodological inappropriateness of this figure it is still relatively low.

In spite of popularly held views, Ireland has historically been an economy with a relatively low taxation burden. Studies by the OECD (2003:18), Collins (2002: 54-56) and Bristow (2004:1) have all shown that since the 1970s Ireland's tax/GDP ratio has always been below the European average and for the vast majority of the last three decades has been below that recorded for the UK. Within the OECD the Irish ratio closely followed the OECD average up until the start of the 1990s. During that decade only Ireland and Poland demonstrated noticeable reductions in taxation burdens. Poland's rate descended from a tax burden at almost 40 per cent in 1990 to a rate of 34.3 per cent in 2002. The Irish decline was from almost 33.5 per cent to a 2002 rate of 28.6 per cent.

Chart 1:



Source: *Calculated from Eurostat, 2004a:239.*
Note: *The unweighted EU average figure is 38.5.*

Madden notes that the view that Ireland possesses a relatively high tax burden is likely to derive from the fact that "for a given amount of tax revenue, the tax base in Ireland is relatively narrow" (2000:99). Table

2 reflects this view in presenting an analysis of the composition of Irish net tax revenues over three years from 2000-2002. It shows that the major sources of Ireland's tax revenue are from taxes imposed on personal income and the consumption of goods and services through VAT and excise duties. In 2002 these three categories accounted for almost two-thirds (65.81 per cent) of the entire tax take. Compared to the rest of the EU the scale of taxation collected on income in Ireland is large; as is the proportion derived indirectly through consumption taxes. Conversely, social security taxes (or social contributions) account for a "remarkably low" proportion of total taxation when compared to other member states (Eurostat, 2004a: 167-170).[4]

Table 2: The Composition of Ireland's Net Tax Revenue, 2000-2002 (% of total).

	2000	2001	2002
Customs duties	0.66	0.50	0.39
Excise duties	14.30	13.04	13.49
Capital acquisitions tax	0.72	0.52	0.44
Capital gains tax	2.50	2.71	1.82
Stamp duties	3.52	3.78	3.34
Residential property tax	0.01	0.01	-
Income tax	29.49	28.84	26.36
Corporation tax	12.56	12.83	14.10
Value added tax	24.20	24.45	25.96
Agricultural levies	-	-	-
Social contributions	12.04	13.33	14.09
Total	**100.00**	**100.00**	**100.00**

Source: *Office of the Revenue Commissioners (2003:10); Department of Social and Family Affairs (2003:7; 2004:8).*

[4] See Bristow (2004:2-6) and Collins (2003:56-59) for further comparisons of the taxation structures of Ireland, the UK, the EU and the OECD.

Is There a Need For Change?

Based on the above analysis, a question arises as to whether there is a need to adopt policies to change Ireland's current low tax/GDP ratio? If there are to be increases in government spending, particularly in the social areas, then the answer to this question is likely to be different over time. This section takes three approaches: immediate, medium-term and long-term.

Immediate

In the immediate or short-term the need for explicit policies aimed at increasing Ireland's tax/GDP ratio are limited. The low 2002 figure recorded above reflects successive budget taxation reductions combined with the effect of a series of miscalculated policy reforms which cost considerably more in tax revenue forgone than anticipated when announced. Recently tax revenues have been increasing at a greater pace than GDP growth and the as yet unpublished ratios for 2003 and 2004 are likely to be higher than 28.6 per cent.

A key issue in the short term is the need to adopt more appropriate fiscal policy management procedures than those used to frame recent Budgets. The exchequer comprises two accounts, a current account and a capital account. The former accounts for the day-to-day activities of the state and incorporates inflows of taxation revenue and outflows of state expenditure on wages, social welfare and training programmes among others. The latter primarily accounts for government investment in infrastructure, buildings, roads and so on. Normally it is accept that a nation's capital account will be in deficit (expenditure greater than revenue), because this generally involves costly investments which generate little immediate revenue. However, in the long run, capital investments are regarded as worthwhile given that their provision facilitates economic activity which in turn produces future flows of taxation revenue.[5]

[5] This assumes that value for money is achieved when Governments make capital investments.

When managing the current account, the established approach is to plan for a surplus in the account (revenue exceeding expenditure) or to balance the account. In the UK the Chancellor, Gordon Brown, has adopted a "golden rule" for budgetary policy which commits him to balance the current account over a cycle of Budgets while running his capital account in sustained deficit.[6] Producing a budget deficit is not regarded as a problem by economists or by most Finance Ministers. As long as the current account is in surplus or balance, the existence of capital account deficits, equalling small percentages of overall GDP, is accepted; indeed it is expected.

In recent years Ireland has attempted to be an exception to this form of fiscal management. During the boom years of the Celtic Tiger the Irish exchequer was awash with money. In spite of cuts in taxation rates, revenue kept coming in and allowed the exchequer to record sizeable current account surpluses. So large were these surpluses, they exceeded capital account deficits and allowed government to record overall budget surpluses. However, that phenomenon was short-lived, and as the economy slowed down so too did current account revenue. Consequently projections for the overall exchequer balance for the next few years indicate the reappearance of budget deficits. Budget 2004 projections from the Department of Finance indicate that these deficits are being driven by sustained levels of capital account investment amounting to almost €6bn a year (Budget 2004: D3). This investment represents an important part of Ireland's infrastructural catch-up with the rest of Europe and Eurostat notes that the scale of this investment is such that if it were halved to the EU average Ireland would be recording an overall exchequer surplus (2004a:167). However, for the years 2004-2006 the Department has calculated that current account surpluses will average at €3.59 billion annually. [7]

[6] This golden rule is often summed up as allowing Britain only to "borrow to invest".

[7] de Buitleir and McArdle (2003:4) have projected smaller surplus averaging €3 billion over the period. Recent data from the Department of Finance (2004) and the Central Bank (2004) suggest that these current account surplus will be greater than projected on Budget day.

The reality of this fiscal outcome is that the Irish economy has returned to a position that other European countries regard as the 'optimal'. Indeed, if anything the Irish exchequer's position would be regarded as super-healthy given the large current account balances. It therefore remains a puzzle why in recent years government has attempted to create the impression that these overall budget deficits are bad news and economically unhealthy. It is equally puzzling why the aim of recent fiscal management policies has concentrated on minimising the overall exchequer deficit and achieving this by contracting spending, and spending growth, in the current account.

It is clear from the Department of Finance projections that there remains significant room for further current account spending over the next few years. Additional spending of up to €1.5 billion a year is feasible. Its effect would only be to reduce the sizeable current account surpluses and to increase marginally the scale of overall budget deficits. Following such a move, the General Government Balance as a percentage of GDP (a key indictor used by the European Central Bank to judge fiscal policy control) would be 2.11 per cent in 2004, 2.39 per cent in 2005 and 1.99 per cent in 2006. These outcomes comfortably comply with the 3 per cent limit set in the Stability and Growth Pact.

Based on these figures, it is clear that there should not be any pressure on the exchequer to adopt policies to increase the overall taxation burden in the short-term. However the situation is different when we take a medium-term view.

Medium-Term

While there are resources available in the short-term, the next few years will see government face a series of new demands on exchequer spending. These include:[8]

[8] The items listed do not represent a compete list.

(i) European Union contributions

From 2007 onwards Ireland will become a net contributor to the European Union. While the scale of that contribution is due to be agreed by June 2005 the sums involved are likely to be substantial.[9]

(ii) Kyoto fines

From 2008 onwards Ireland will face fines due to breaches of the Kyoto protocol. In 2003 our greenhouse gas emissions were 24.7 per cent above the 1990 level (Ireland's Kyoto target is to limit emissions to 13 per cent above the 1990 level in the period 2008-2012). While the extent of this breach is likely to reduce before 2008, through improvements and emission trading, fines of the order of €100-150m per annum (€500-€750m over 5 years) can be anticipated.

(iii) Demographic demands

Population data and projections from the CSO (2004b) show that over the next few years two demographic phenomena will emerge. These are: increases in the number of children of school going age and increases in the number of elderly people. Both these trends have implications for spending in the education and health sectors and both will require additional exchequer spending over the next 15-20 years.

(iv) Overseas Development Assistance

In speeches by the Taoiseach to the United Nations and in the national agreement, *Sustaining Progress*, the government has commitment itself to "meeting the UN target of 0.7 per cent of GNP expended by 2007 on overseas development assistance (ODA)" (2003:54). Achieving that target will result in ODA more than doubling from €422m in 2002 to almost €900m in 2007. [10]

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9 Agreement of principals and guidelines is due in December 2004 with political agreement due in June 2005.

10 See CORI (2004:167-169) for projections of GNP growth and the size of these ODA commitments.

(v) NAPS commitments

The *National Anti-Poverty Strategy Review* (2002) and *Sustaining Progress* (2003) committed the government to the following target:

> To achieve a rate of €150 per week in 2002 terms for the lowest rates of social welfare to be met by 2007 and the appropriate equivalence level of basic child income support (i.e. child Benefit and Child Dependent Allowances combined) to be set at 33 per cent - 35 per cent of the minimum adult social welfare payment rate.

To achieve this over the next three years government expenditure on welfare payments will have to substantially increase.

The above demands, will force government to choose one of three paths: radically cut current account spending; scale back capital investment; or collect more tax revenue.[11] Of these three approaches, the first is unlikely given acknowledged existing shortfalls in the governments current account spending. At a glance the second choice seems more feasible, however addressing the infrastructural gap between Ireland and the other leading EU economies is likely to be a process which will continue for a further 10 years. As priorities shift from motorway construction to secondary roads and urban transport systems in all our cities it would be unrealistic to expect reductions in the exchequer commitment to the capital account. Therefore the third alternative seems most likely and as such increases in the tax/GDP ratio seem inevitable.

[11] I am assuming that the option of borrowing to fund these current account commitments is not to be considered.

Long Term

In the long-term, Ireland should be able to return to a tax/GDP ratio somewhat similar to that currently recorded. Although the above commitments will continue to place demands on current account exchequer spending, the potential for change lies in the capital account. The rate of capital investment on infrastructure now stands at twice the EU average. Over time, as infrastructural convergence is achieved, Ireland's capital account expenditure should fall to the European average. The resulting decrease in demand on government expenditure should allow for taxation reductions and the tax/GDP ratio to fall once again.

Increasing the Tax/GDP ratio

Suggesting that any country's tax take should increase normally produces negative responses. People think first of their incomes, and increases in income tax, rather than more broadly of reforms to the tax base. Furthermore, proposals that taxation should increase are often rejected by suggestions that they would undermine economic growth or that they would damage competitiveness. Neither of these arguments stands up to scrutiny.

Alongside Ireland, the British economy is considered to be one of the healthiest in Europe. Over the last number of years it has achieved low unemployment and higher levels of growth compared to other EU countries (OECD, 2004; Eurostat, 2004b:10-11). These have been achieved simultaneous with increases in its tax/GDP ratio. In 1994 this stood at 33.7 per cent and in 2002 it had increased 2.1 percentage points to 35.8 per cent of GDP. Furthermore, in his March 2004 Budget the British Chancellor Gordon Brown indicated that this ratio would increase again to reach 38.3 per cent of GDP in 2008-09 (2004:262). His announcement of these increases was not met with predictions of economic ruin or doom for Britain and projections of economic growth suggest that it will remain high compared to other EU countries (IMF, 2004; Eurostat, 2004b:10-11).

Another country that has achieved ongoing economic success while simultaneously increasing its tax take is the United States. Between 1990 and 2002 it increased its tax burden by 2.2 percentage points from 26.7 to 28.9 per cent of GDP.[12] Both these examples show that there is no trade off between small increases in the tax burden and economic success.

For a small export-orientated trading economy like Ireland, competitiveness is critically important. However, the suggestion that higher levels of taxation would damage our position relative to other countries is not supported by international studies of competitiveness. Annually the World Economic Forum publishes a *Global Competitiveness Report* ranking the most competitive economies across the world. Two lists are produced: one ranking the most competitive economies and a second listing the most competitive business environment.[13] Tables 3a and 3b outlines the top fifteen economies in each index as well as the ranking for Ireland. They also present the difference between the size of the tax burden in these, the most competitive, economies in the world and Ireland for 2002. With the exception of Japan, all of the most competitive economies in the world collect a greater proportion of national income in taxation.

[12] In fact the US ratio increased to 29.7 per cent of GDP in 2000.

[13] See World Economic Forum (2003: xii-xx) for a full explanation of these indices.

Table 3a: Differences in taxation levels between the worlds 15 most competitive economies and Ireland.

Competitiveness Rank	Country	Taxation level versus Ireland
1	Finland	+17.3
2	United States	+0.3
3	Sweden	+22.0
4	Denmark	+20.3
5	Taiwan	*not available*
6	Singapore	*not available*
7	Switzerland	+2.7
8	Iceland	+8.1
9	Norway	+15.6
10	Australia	+1.5
11	Japan	-1.3
12	Netherlands	+10.9
13	Germany	+11.6
14	New Zealand	+6.3
15	United Kingdom	+7.2
30	IRELAND	-

Source: World Economic Forum, 2003:xiv

Notes: a) Taxation data from non-EU countries is from OECD (2003:18).

b) For some countries comparable data is *not available*.

c) Taxation figures for Norway are from Eurostat (2004a:239).

Table 3b: Differences in taxation levels between the worlds 15 most competitive business economies and Ireland.

Competitiveness Rank	Country	Taxation level versus Ireland
1	Finland	+17.3
2	United States	+0.3
3	Sweden	+22.0
4	Denmark	+20.3
5	Germany	+11.6
6	United Kingdom	+7.2
7	Switzerland	+2.7
8	Singapore	*not available*
9	Netherlands	+10.9
10	France	+15.6
11	Australia	+1.5
12	Canada	+4.9
13	Japan	-1.3
14	Iceland	+8.1
15	Belgium	+18.0
21	IRELAND	-

Source: World Economic Forum, 2003:xix
Notes: a) Taxation data from non-EU countries is from OECD (2003:18).
b) For some countries comparable data is *not available*.

Ireland's position on these two indices has deteriorated in recent years. Between 2002 and 2003-04 Ireland slipped from 23rd to 30th on the global competitiveness index and from 20th to 21st on the business competitiveness index. The reasons stated for Ireland's loss of competitiveness included decreases in economic growth, poor performances by public institutions and a decline in the technological competitiveness of the economy (2004: xv). Interestingly, a major factor in that decline would seem to be related to underinvestment in state funded areas: education; research; infrastructure; and broadband connectivity. Each of these areas is dependent on taxation revenue and have been highlighted by the report as necessary areas of investment to achieve enhanced competitiveness. As such, lower taxes do not feature as a significant priority, rather it is increased and targeted government spending. Similar points to these were expressed by the Nobel Prize winning economist Professor Joseph Stiglitz when he commented on Ireland's long-term development prospects in Dublin during June 2004.

One further myth is that Ireland would loose its branding as a "low-tax economy" if policies were adopted to increase total tax revenues. Such a suggestion, though often cited, ignores the fact that many economies who tax at higher levels than Ireland are regarded as "low-tax". Countries such as Britain and Spain continue to be described as low-tax economies in spite of them having a tax burden at between 7-8 per cent higher than Ireland. Put simply it is possible to increase the tax burden without eroding Ireland's claim to be a low-tax economy.

Table 4: Additional exchequer revenue from increases in the Irish tax burden, 2002

Increases	€'s
+ 0.3% to 28.9% of GDP	€383.9m
+ 1% to 29.6% of GDP	€1,279.9m
+ 1.4% to 30% of GDP	€1,791.9m
+ 2.4% to 31% of GDP	€3,071.8m
+ 7.2% to 35.8% of GDP	€9,215.4m

Finally, it is important to note that small increases in the tax burden result in substantial increases in exchequer revenues. Table 4 presents the *ceteris parib*us exchequer revenue implications of a higher tax burden using data for the 2002 fiscal year. It shows that were Ireland to increase the tax burden by 0.3 per cent, and tax at the same level as the US, government revenues would increase by over €380m a year. A one per cent increase produces an extra €1.28b in taxation revenue while an increase of the tax burden to 30 per cent of GDP would see the exchequer collect almost €1.8b in additional revenue. An increase of 2.4 per cent would increase revenues by €3b. Finally, were Ireland to increase its tax revenue to the level of the UK, by 7.2 per cent, additional revenues of €9.2b would be available to government annually.

Conclusion

This chapter carries three key messages. First, Ireland is the country with the lowest tax burden in the European Union. Second, with better fiscal management, increases in the tax burden are not necessary in the immediate/short-term. However they are inevitable in the medium term as government faces a number of unavoidable new demands on its resources. Finally, the chapter suggests that large increases in exchequer revenues are possible from small increases of the tax burden and that these can be achieved without damaging economic growth or competitiveness and while retaining Ireland's well deserved title as a low-tax economy.

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2
Expanding the Tax Base

2.1

Land Value Tax : Unfinished business

Emer Ó Siochrú

1. An Irish Taboo

It always amazed me how conversations on any convivial occasion in Ireland become hushed when the subject of land is raised. And when the word land and tax are included the same sentence, a complete pause accompanied with much sad shaking of heads is almost inevitable. To be honest, I am not truly surprised because I was not immune to this native sensitivity. My work as an architect promoting community development and environmental sustainability - where land issues simply cannot be ignored - desensitized me. It led me to study valuation surveying as a mature student to get a better understanding of the dynamics involved. Without the taboo, whole vistas of practical solutions to intractable problems such as poor urban and village design, unaffordable housing, poverty, and social exclusion came sharply into focus. My curiosity since turned to how and why consideration of taxing land is so off-limits. History as I will show, suggests that there is still considerable unfinished business from the 'Irish land struggle ' fueling our guilt and denial around the subject. I advise that some of what follows will be disconcerting and upsetting of comfortable assumptions…

The noted historian of Irish land history, W. E. Vaughan, discusses the exclusive focus on ownership and possession of land to the almost universal neglect of discussion on the *nature* of its ownership or how rights and responsibilities and revenues from it might be most efficiently and equitably assigned.[1] The Irish land struggle started out promisingly enough in the 1880s with a clear mandate for the three Fs of Fair rent, Fixity of tenure and Free sale of tenant improvements or tenant right. This provided an excellent structure with which to understand the dynamics of property in land. Michael Davitt of the Land League had a clear vision of what legislative and fiscal changes were needed for Irish peace and prosperity which he shared with Henry George, the American social and economic reformer.

> *I would abolish land monopoly by simply taxing all land, exclusive of improvements, up to its full value…In other words, I would recognize private property in the results of labour, and not in land.*[2]

Others leaders were less clear however, and in the tumult of the land war, the subtleties of the three Fs were lost in the beguiling prospect of the 'right to buy'; the redistribution of land from the landlords to the tenant farmer.[3] Ownership became the single dominating issue and re-balancing the bundle of rights and responsibilities of land amongst all interested stakeholders was forgotten.[4]

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[1] Because of the well established obsession with landlord–tenant relations, and the events of 1879-82, the whole issue of Irish land came to be viewed exclusively in terms of ownership and occupation. Against the drama of evictions and agrarian crime, the minutiae of agricultural improvement and rural organization seemed dull; against the contending claims of landlords and tenants, the claims of other groups – landless labourers, taxpayers, and city people who wanted access to land seemed less pressing. As a result, when landlordism was abolished, it was replaced by a highly private system of ownership. Public control was limited to the modestly exercised powers of the Land Commission; the landlords as centres of power were not replaced; farming became confined to those who inherited land, with some exceptions; physical access, even to stretches of beach, became a matter of private arrangement. Thus, despite the Land League's campaign, the 'land for the people' did not lead to the establishment of great national forests, to areas of common land, or even to public footpaths. (P 41) Vaughan, WE, *Landlords and Tenants in Ireland 1848-1904,* Dundalgan press 1st published 1984, latest revision 1994, ISBN No. 0947897011

[2] Davitt, Michael, *Some Suggestions for the Final Settlement of the Land Question* (1902)

[3] Silagi, Michael, 2000, *Henry George and Europe*, (P. 48) Robert Schalkenbbach Foundation, New York, ISBN 0911312919

[4] Jordan, Donald E, *Land and Popular Politics in Ireland*. 1994, Cambridge University press, ISBN No. 0521324041

Redistribution of land ownership

The land question and the history of its 'resolution' particularly any critical examination of the winners and losers from the process is still very sensitive politically. Some commentators hold that it is the root of Unionist opposition to the Irish Republic and the northern conflict to this day.[5] Access to Land Commission records continues to be highly restricted despite the fact it has hardly functioned for 30 years. Terence Dooley was forced to rely on a variety of other sources to write his recently published and very important book 'Land for the People'[6]. Dooley shows how first, Cumann na nGadheal / Fine Gael and then, Fianna Fáil failed to find an equitable and efficient system to apportion the nation's land. Considerable evidence exists that the share-out of the available land was not as even-handed as the Land Commission intended and maintained; ruling political party's supporters benefited disproportionately at different times. In the nature of things there could be only a few winners – western tenants, the town merchants, first born sons, and many losers– women, most labourers and all urban dwellers. In a system where apportioning rights was restricted to the blunt instrument of ownership and possession of land on a finite island, only wide scale emigration of the disinherited underwrote such redistribution as was possible.

5 Hussey, Christopher, *For Protestant Self Determination; The Key to the Ulster Que*stion, 2001, Dunesk Press, Dublin ISBN No. 0951021818.

6 'In October 1933, the new Fianna Fail government introduced its own extensive and complicated act, which provided the catalyst for record acquisition division statistics 1934-5 and 1935-6 and was very much as Patrick Hogan contended, a 'political act' that pandered to the small farmer and labouring classes in an attempt to secure votes. After the terms of the act became known, there was a rather dramatic growth in the number of Fianna Fail *cumainn* from 1,265 in 1932 to 1,679 in 1933. This growth was partly the result of more organized and sustained efforts by Fianna Fail organizers in the rural constituencies but it also owed much to the stimulus provided by the 1933 Act and the widely held belief that one would have to be a member of a *cumann* in order to benefit from division'. (P 206) Dooley, Terence, *Land for the People; The land Question in Independent Ireland*, 2004, UCD Dublin ISBN No. 1904558151pb

It is astonishing to see just how much of the early state's revenue - 5.4% in the early 1930s [7]- was used to placate land hunger in rural areas to the relative neglect of pressing urban problems. This rural focus extended to providing subsidised housing for farm migrants from the West to the more fertile midlands and the rural labourer.[8] Rural areas got more than *ten times* the social housing investment of urban areas. Local authority housing tenants moreover, were given the right to buy their house from the outset - a right only offered to urban flat tenants this year of 2004. Any debate about government financing or national development priorities was constrained by the myths and hopes generated by the ongoing land redistribution process and its political importance in generating votes.

> *Thus the land question remained possibly the most potent political issue in rural Ireland long after independence and one of the great determinants of political survival and decline" (P229-30 Dooley.)*

7 'In May 1923, the Minister for State, Patrick Hogan, estimated that it would cost the state up to £30 million to complete land purchase at a time when the country was only just emerging from an atmosphere of unreason and irresponsibility'. This money could only be raised through a loan from the British government. In a Dail speech in 1925, Hogan put the scale of the operation into perspective for his fellow TDs: "It is an enormous loan when compared with ordinary development, say, with the development of the Shannon, a gigantic scheme, but at the outset which is only going to cost about five million pounds. Thirty million pounds for land purchase is a very expensive matter, very much more expensive than any other.' (P 19) , Dooley, Terence, *Land for the People; The land Question in Independent Ireland*, 2004, UCD Dublin ISBN No. 1904558151pb

8 'By independence, 50,862 local authority dwellings had been built in Ireland, 41,653 of which were constructed under the Labourers Acts, and accounted for about 10% of rural housing stock, while only 8,861 dwellings had been completed by the urban authorities.' (P 170) Norris. Michelle, Chapter 9 Housing in Callanan & Keogan, *Local Government in Ireland : Inside Out,* 2003, IPA Dublin, ISBN No. 1902448936

The early governments were negligent in allowing the valuations of land and property - the basis for determining rates charges – to become out of date, perhaps because of the high sensitivity of any inquiry into the value and use of land under the spectre of the Land Commission. The growing inconsistencies and lack of fairness of the antiquated rates assessment system gave an opportunity to first Fine Gael and then Fianna Fail to make political capital. A ‘race to the bottom’ ensued which Fianna Fáil won in 1977 by announcing the total abolition of domestic rates. The abolition of rates on farmland and farm buildings followed predictably shortly afterwards in 1984 as the result of a legal challenge.

Planning gain, political corruption and local democracy

The political minefield of the land and that of its equitable distribution and efficient use continued in a new incarnation, from a focus on farming, to a focus on planning and development. Many landowners (some beneficiaries of Land Commission redistribution) were seen to make huge windfall profits when their land was rezoned and developed for housing in the economic boom of the 1960s and early 70s. The high cost of acquiring land for local authority housing also became a hot issue politically. The result of this growing concern was the Kenny Report of 1971. It is not perhaps surprising, given previous history, that Kenny concentrated on changing ownership rather than altering the nature of ownership to find a solution. The majority Kenny recommendations - for the compulsory purchase of potential development land by local authorities at existing use value plus 20%- were again, not surprisingly, never implemented. The practical difficulties – now well understood from the experience of the Land Commission - of delivering both equity and efficiency under a system which relied solely on acquisition has prevented high minded rhetoric from translating into reality.

Governments fudged the issue and fell back on a 60% CGT on development land although it had been proven ineffective for that purpose in Britain. The economic doldrims of the 80s brought neo-liberal economic theories of stimulating development through tax cuts and a short term reduction to 20% of all CGT was announced with firm warnings to landowners that it would be increased again to previous levels within a short time. No one was really surprised that the warnings were not fulfilled as cuts to capital taxes did indeed seem to deliver their promise. The conclusion by an almost all-party political consensus, erroneously drawn, was that *all* taxes on land, without discrimination, have an inhibitory action on economic activity. The land speculators and political fixers were given effective fiscal immunity during the recent economic boom.

We can see echoes of the old political fear of the power of rural landowners in the exemption of most rural housing from contributing to social and affordable housing under Part V of the 2000 Planning and Development Act. Their power was seen again, championed now by the Irish Rural Dwellers Association, in the hastily published Guidelines for Rural Housing before the local elections. These guidelines, part of the National Spatial Strategy (NSS), bestow special favourable planning treatment on rural dwellers, landowners and their families for housing development over their urban counterparts. The extra costs of servicing the resulting scattered rural housing will fall, predictably on previous form, on the mostly urban taxpayer and the social exclusion it will intensify, will be borne exclusively by the village, town and city dweller.

The land struggle and its semi-resolution caused a major transformation in the economic and social structure of the nation that still resonates today. As Vaughan states in his conclusion;

> *"Above all, the land ceased to be a source of revenue; in the 1860s for example, 25% of total Irish revenue was raised directly by taxes on land; in the course of the twentieth century, the expiry of land purchase annuities, the abolition of local government rates, and the growth of central government's assistance to agriculture have transformed the land into a net receiver of public revenue. (P41)*

The narrow range of functions of Irish Local Government has also a historical explanation in the circumstances in which the new state was founded. Education for instance, was delivered by the Catholic Church and remained in their hands for many years after independence. Policing functions, because of the near anarchy in many rural areas, were kept away from local authorities. In the chaotic conditions of the early state many unacceptable practices, particularly around procurement, were commonplace in the local authorities, which the high minded new Dáil addressed by a centralised, equitable system.

The question that faces us now is whether these historical determinants have validity or should have any power in the present day? In particular, we should be mindful of outdated assumptions that stand in the way of a lasting solution to government funding and spending problems. Such a common and rarely challenged assumption is that it is not politically possible to reintroduce any form of taxes on land in Ireland. This question is too important to be prejudged.

Conditions have changed radically since Davitt first introduced the concept of land taxes to the Irish people as a solution to their poverty and undevelopment. Most of the desperate land hunger has been satisfied and Ireland has become a nation of widespread, relatively modest landowners.[9] The Planning Tribunal revelations of the excessive profits and endemic corruption, which our current concept of the rights of freehold landowners engenders, have created demands for reform. Old problems are re-emerging in agriculture concerning the concentration of farmland ownership in fewer hands; the return of the tenant farmer and land leasing and the uneconomically high price of farmland. Finally, alternatives to land taxes as the basis of government financing have been tried and have been seen to be deficient.

[9] Cahill, Kevin, *Space, perception and real reality. Land and the future Irish community.*, Feasta Conference on Community and land. Dublin 9/10 October 2003.

A second, less openly articulated assumption but just as powerful, is that we cannot entrust local authorities with further powers and responsibilities without risking corruption and inefficiencies. Proliferating Section 140s and late night rezoning sessions in some local authorities have brought disrepute on all elected local representatives. The planning profession is being demonised for its impossible role of deciding winners and losers in the planning benefit bonanza - much like the Land Commission was in the past. Again, events have shown that central government representatives and officials are not immune to veniality and greed eyther.

> *In the Irish context, mistakes made by local authorities are sometimes used as the basis for intervention, and occasionally for appropriation of responsibility, by the centre. The reverse does not seem to apply – mistakes by central government are not held to justify devolution to local government. (P 48, 9 Callanan & Keogan)*

It is not the level of governance that predisposes to corruption but the temptations generated by our fiscal, procurement and planning systems. Past mistakes should be a source of education, not a prohibition on our agreed objectives for effective local democracy.

2. ***Pre*****distribution instead of *****Re*****distribution**

Let us now look more closely at how Michael Davitt might approach our current land and planning benefit question. According to him, the principle underlying all funding and spending based on natural resources (natural capital) should be that of ‘equity’ not ‘charity’; i.e. a rights-based approach. No individual human can claim to have created natural capital by their labour and/or capital therefore natural capital is fundamentally different from other forms of private property. However, as the collective consciousness of the Earth, humanity can claim a sort of common right to it.

> *The equal right of all men and women to the use of land is as clear as their equal right to breathe the air. It is a right proclaimed by the fact of their existence. For we cannot suppose that some men and women have a right to be in this world and others do not.*[10]

This common right of each human being to benefit from the Earth's natural capital should be protected and respected by legitimate governments at the appropriate level. Service infrastructures created by the state out of taxation receipts are also part of a common inheritance and are inputs into economic activities. From this basic premise comes the legitimacy for common resource taxes/rents and charges. Equity is achieved by pro-rata taxation/rents/charges (that recognize environmental limits) for the benefits derived from common resources, which are then allocated universally on an equal per capita basis.[11]

This is NOT a Marxist prescription of 'from each according to their ability, to each according to their needs' but 'from each according to their use of common resources, to each their equal share'. [12] This individual right to common resources and/or economic inputs is *not* mediated by government or society.

[10] George, Henry, quoted in *A Geolibertarian FAQ* By Todd Altman http://members.aol.com/_ht_a/tma68/geo-faq.htm#rothbard

[11] 'It is not enough that men and women should vote; it is not enough that they should be theoretically equal before the law. They must have liberty to avail themselves of the opportunities and means of life; they must stand on equal terms with reference to the bounty of nature. This is the universal law. This is the lesson of the centuries. Unless its foundations be laid in justice the social structure of the United States or any other country cannot stand'. George, Henry, *Progress and Poverty*, Hogarth press London 1st published 1879, 1979 edition.

[12] 'The state's new role towards the market and the citizen should thus be to decolonise and empower. Whether to call this a basically capitalist or socialist approach is a matter of personal choice. It will aim to integrate economic efficiency with economic justice. So you could call it both capitalist and socialist or neither, whichever you prefer.' (P.5) Robertson, James, *Sharing Limited Resources and a Change of Course*, 2003 paper delivered to the Pio Manzu International Research Centre Rimini Italy, www.jamesrobertson.com/article/roleofmoneyandfinance.pdf also in Feasta Review No. 2 to be published shortly.

> *..the idea that an individual has "property" in land only to the extent that there is, in the words of John Locke, "enough, and as good left in common for others." In that sense, the right to land is not a collective right, but an individual right that exists independently of the collective (i.e. "society"). The equality of this right is merely a limitation that arises from the presence of others with like rights. By contrast, a collective right to land dictates that an individual does not have a right to use any land unless society — either explicitly or by omission — has granted him the right to do so.*[13]

This concept appears to be a very difficult distinction for many media and political pundits to understand. It marks the boundary between the old 'red' economic analysis and the new 'green' economics of sustainability. James Robertson, a seminal economist within the movement describes this new fiscal paradigm as follows ; -

> *This will involve a shift from redistribution to the idea of predistribution. Whereas redistributive taxes aim to correct the outcomes of economic activity, predistributive taxes and charges will share the value of essential inputs to economic activity. Whereas redistribution is dependency reinforcing, predistribution will be empowering. It will correct any underlying cause of economic injustice, inequality exclusion and injustice.*[14]

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[13] Altman, Todd, *A Geolibertarian FAQ*, http://members.aol.com/_ht_a/tma68/geo-faq.htm#rothbard

[14] Robertson, James, *Sharing Limited Resources and a Change of Course*, 2003 as above

Redistribution takes the form of a guaranteed income to every citizen that replaces existing subsidized state benefits and services [15]. It has been called variously a citizen's Income or basic income and has a long history of discussion by politicians but has never been achieved in practice.[16]

It makes such good economic and social sense, that some neo-liberal economists have re-named it and claimed it as their own, without acknowledging its provenance. The following is an excerpt by UCD economist Constantin Gurdgiev in a recent critique of CORI's input into social partnership wherein he outlines his recommendation for a Personal Purchase Account (PPA) to counter the proposals of – as he puts it – 'our semi-professional equality pundits'.

> *A PPA system will see the government allocating a single annual payment to the individual or a family. The recipient of these funds will be free to spend on purchasing public and private services according to their choice. …Ultimately, the government's role in managing PPAs should be reduced to ensuring the minimum quality of service provisions, allowing private providers to compete on price and quality options, while encouraging consumers to shop around. Jobs created in the process will benefit those willing to move out of dependency.*[17]

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15 'Citizen's income – a tax free income paid to every man, women and child as a right of citizenship... CI for children will replace today's child benefit, and CI for the elderly will replace today's state pensions. There will be supplements for disability, housing benefits, and other exceptional circumstances. Otherwise, CI will replace all existing benefits and tax allowances. The amount of a person's CI will be unaffected by their income or wealth, their work status, gender or marital status.' Robertson, James, (P. 81) *Sharing the value of common resources through taxation and public expendature, Feasta Review,* Ed. Douthwaite, R and Joplin,J, 2001

16 See Robertson , James, (P. 12)1994 *Benefits and Taxes, a radical strategy*, New Economic Foundation 1994, http://www.jamesrobertson.com/ne/benefitsandtaxes-1994.pdf for a full history,

17 Gurdgiev, Constantin T, *Why FF should shut out CORI*, The Sunday Business Post 12th September, 2004

Any reader who can spot the essential difference of the PPA to a citizen income (see footnote) has more critical discernment than I have.

Other economists or political scientists might respond to a CI in alarm and cite the impoverishing effects of the Speerhamland Poor Law in Britain, repealed to no one's regret in 1834. The economic lessons of Speerhamland were so powerfully engrained in the minds of many British politicians as to have delayed the desperately needed humanitarian aid for the famine in Ireland[18]. The main lesson from this misguided benefit system has been, wrongly drawn, as the absolute need to distinguish the 'deserving poor' from the merely poor when allocating the proceeds from land taxes. The true lesson should have been that *all*, not only the deserving *and* merely poor, should share in the commonwealth.[19]

[18] King, Carla, Famine Land and Culture in ireland, 2000, UCD ISBN 1900621479

[19] 'The historical parallel with Speenhamland is false. Under the Speenhamland system, parish ratepayers were obliged to bring the wages received by labourers in their parish up to a given level in accordance with the changing price of bread. Thus, unlike CI, Speenhamland – until it was abolished in 1834 – effectively prevented the establishment of a competitive labour market. Unlike CI, Speenhamland limited the amount that people could earn from more and better work. CI will not keep workers dependent on employers, as Speenhamland did; it will strengthen workers' negotiating position with employers. It will not enable big employers to shift wage costs on to independent self-employed people – today's equivalent of freeholder ratepayers in the 18th and 19th centuries – as Spennhamland did. Nor will it enable big employers in one parish to shift their wage costs on to ratepayers in the adjoining parish (if their workers live there), as Speenhamland did.' Robertson, James, (P. 16) *Benefits and Taxes, a radical strategy*, New Economic Foundation 1994,
http://www.jamesrobertson.com/ne/benefitsandtaxes-1994.pdf

What does all this say to us about land ownership and its benefits in Ireland? Firstly It makes the question of who has possession of the land far less important than whether they are using it wisely and efficiently. With a significant part of the economic rent from the land remitted back to each citizen equally, freehold ownership loses much of its monopoly power. Secondly, the benefits of new fairer land and resource taxes should be passed as directly and as universally as possible to citizens. Transition to the new fiscal system of course, must take account of existing structures and leave time for adaptation. But a start should be made immediately to take advantage of the current review of local government finance.

The principle for the spending of the revenues raised by the various LVT measures should be to return that portion of the value-added back to the authorities that created it as far as possible, and that what is left, being the pure economic rent derived from the natural or locational quality of land, should be shared out equally as the beginnings of a Citizens Income (or Basic income) to be used to purchase public and private *and third sector* goods and services.

Value-added by national investment such as national roads, airports, railways, hospitals, third level colleges, decentralised government offices etc. could form the basis of a revised local authority block grant to be used to equalise revenues across local authorities. Apportioning this value is a political decision to be negotiated at national and local level. Value-added by the local business and social community investment should, by the same token, be assessed and spent by a representative partnership local body such as the City and County Development Boards (CDBs) through a 'participative budgetary' process. An independent source of funds for local sustainable development investment might prove just the thing to rescue these partnership structures from total irrelevancy.[20]

[20] See more on this subject in Comhar's report to the DoELG, *Recommendations for Small Village Development and Submission on Sustainable Rural Housing*

3. Tax Shift

Theoretically, an annual rental charge should be levied on all land such that all the 'value-added' by the community is captured for the community. If that were so then there would be no need for any other charges or taxes – a 'single tax' was Henry George's great aim. But, people find taxes based on income and profits reassuring as they pay according as resources are available to them and they hope to benefit from the incomes and profits of others in hard times or in old age. There probably will always be a need for some income and profit taxes linked to redistribution based on need - as insurance in a risky world. But as a tax on *outputs* of the economic system, they make it hard for the poor to build wealth in good times and, as they are measured in the virtual accounting system of money, the rich find them easy to avoid and evade. Globalisation is accelerating the mobility of money and profits such that some fiscal response is absolutely necessary. George Monbiot points out that transnational corporations;

> "*…will install their webservers where taxes are lowest, disguise their trade in goods as trade in services, and even launch their own virtual currencies. The tax burden, in other words is shifting to those who are unable to move their assets offshore or out of the old economy into cyberspace. With little else to offer, poor countries (and spaces) end up giving everything away in a desperate attempt to attract investment. If taxation is not to become wholly regressive, we will have to revolutionize the means by which the rich are charged.*[21]

The tax shift from income, profits, transactions, and even capital to the use of environmental resources should begin at local government level as that is the level of governance most directly involved in environmental resource management. There is ample scope for a net increase in some receipts at local level without affecting potential for

[21] Monbiot, George, 2000 P.13 *Guardian Weekly*, 30th March 2000

economic development. In other areas, a revenue neutral 'tax shift' from centralized taxes on labour and transactions is called for. These rents can have different forms; such as capitalized levies and user charges *as well as* annual rental charges, so as to address transitional and/or planning control effects. For instance, roughly 40% of planning permissions for development in Ireland are granted on non-zoned agricultural land in Ireland, representing a massive increase in land values. A necessarily modest annual tax/rent charge alone would exempt these landowners from their fair contribution. User charges, on top of rental charges, are also vital to constrain consumption of resources to within their natural carrying capacity or to address the problem of free riders.

4. Connectivity and Land

The telecom sector has evolved a model for charging for the benefit of connection to virtual communication and informational resources which is useful as a framework for connecting real natural and common resources. Broadband providers typically ask for three kinds of payment; - a connection charge, a rental charge and a use charge. Each competing telecom provider weighs the charges in different proportions according to the nature of the resource; or to attract a particular customer segment; or to benefit from their own particular strengths or to ration their available capacity. It is no different for natural resources that have different attributes calling for differing mixes of charges. So for instance, clean air is a commons to which all are already connected (or would not be alive) so a connection charge would not make much sense. Ditto a flat rental charge. In the case of a limited and vulnerable resource such as the atmosphere, use charges are more appropriate. This is the basis of the EBCU proposal developed by Feasta with the Global Commons Institute[22]and see Richard Douthwaite'a paper in this publication. But for three-quarters of all natural resources, local government is the appropriate level for the conservation and management of natural resources as confirmed in

Local Agenda 21 of the Rio Declaration. In the case of land, a natural monopoly of space, which gives access to other natural and public infrastructure resources, all three charges; connectivity, rent, and user fees are appropriate. Applying this structure to current revenue sources, we can see that many elements of a LVT charging system are already in place.

Connectivity charge – Development levies

Connectivity charges are related closely to development levies provided for under Section 48 and 49 of the 2000 Planning and Development Act. These levies are based on the cost of providing connection to roads, water, drainage waste and stated services to the particular site. It is 'connectivity' to public services and amenities, which comprises most of the value of the land. Yet, under the 2000 Act this levy is based on a difficult to calculate 'estimated cost' rather than a 'value-added' basis. Value-added is the basis of all private service charging and the basis, according to government, on which all public services should be provided and paid for. The anomaly between this stated objective and development levies should be tackled immediately as part of local government financial reform.

Value-added by planning permission - conceptualized as permission to connect to public services - is simply calculated by subtracting the value of the land without planning permissions from the value of the land with permission. Each unit of land is assessed at its bare site value, with all surrounding land taken as being in its existing condition. The valuation is based on optimum use within whatever permissions and constraints apply.[23] New technology in computers and mapping makes it very easy to generate GIS (geographical information systems) contour maps of land values from market information of site

[22] 'The purchase of emissions permits from under-consuming nations by over consuming ones would not just provide an income stream for the poorer parts of the world. It would also be a means by which the rich countries would pay off their ecological debts.' Feasta website: www.feasta.org or go to the document directly http://www.feasta.org/events/debtconf/sleepwalking.htm

[23] From *Options for Local Government Finance ; Proposals for the reform of local government finance in the UK*. July 2004, Law, Henry Land Value Taxation Campaign. http://www.landvaluetax.org.ik

and property transactions. Northern Ireland has just completed a complete GIS map of property values including land values for the whole province. A conference this month in Oxford, UK will hear of a trial land / site value mapping of the Botley area by Tony Vickers School of Surveying Kingston University. Site value contours are used in Pennsylvania as the basis of the 'smart tax' in four cities. Site values are probably easier than any other local tax to assess and keep up to date once the base mapping has been completed.

Critics may argue that the value-added to land by the connectivity of planning permission includes investment by central government such as public transport nodes, motorways, schools, and hospitals not just investment by local authorities. Section 48 and 49 does not allow all such investment to be considered when assessing charges. For instance, schools of all kinds are excluded. We accept this criticism. The section should be amended to include recouping a portion of all value-added by *all investment;* - that created by central government investment but also that created by third parties in the private sector. A new shopping center adds value to neighboring sites, for instance.

The legitimacy of site/land value taxes of all kinds rests in part on the distribution of the receipts on as fair a basis as possible. Central government could pool their share of the development levy funds and redistribute them to redress imbalances in revenue between wealthy and poorer authorities. In particular, there is a compelling case for distributing a portion of development levy revenue generated by infrastructure investment made under the NSS such as rail and road transport links, 3rd level institutions and medical facilities etc to central government for redistribution where needed. Under the current system, towns that are lucky enough to be designated as hubs and gateways in the NSS will receive the lion's share of infrastructure investment and public development. Their residents and landowners will gain not only the benefit of better services and shorter travel times, but also the rise in land values that will inevitably attach to their property. It seems only fair that some of this value should be recouped through development levies and other land value taxes and used to help the towns and villages that missed out.

The next question is; - what share of the value-added to land can or should the local authority recoup? Economic theory states that all of the ‘value-added’ can be recouped without affecting economic growth or disincentives to investment. The Municipality of Basel, Switzerland successfully levies a 50% site value tax with the support of developers who like the certainty and clarity it brings to property valuation and planning[24]. They know that since every developer bidding for the land will have to pay the same unavoidable levy, they will bid less and land will fall in price. In other words, neither the developer nor the finished development buyers will pay the levy but the landowner- through a lower price for the land. This is a counterintuitive economic fundamental that is hard to grasp – even for some economists. Urban economist and valuation surveyor, Tom Dunne sets out the economic logic clearly in his paper to the Oireachtas Committee on Private Property.[25] The School of Philosophy and Economic Science submission to the same committee sets out an even more comprehensive case listing support for LVT from many Nobel Prize winning economists[26]. These submissions with Feasta’s, and others to a lessor extent, had an impact and the final report included a positive recommendation of LVT.

The final equation informing the optimum percentage of the ‘value-added’ under the development levy is a function of what other land rents and / or the user charges are also being levied at the time.

24 Presentation by Basel City authorities, RIAI Conference October, 2003, Basel Switzerland

25 Dunne, Tom, *Submission to the All Party Oireachtas Committee on the Constitution on Private Property*, 30 May 2003

Rental charge - Zoning levy

A practical and politically acceptable route to introducing rental charge is to introduce it when land is freshly zoned as under a Development or Area plan. Zoning declares that planning permission for the appropriate development will be considered favorably and the greatest addition to the value of the land occurs at that point. There is growing political appetite for an annual rent/levy on zoned land as a way of stimulating prompt development or sale of zoned land as there is evidence of land hoarding in Dublin and other cities and towns. In order to counter this, local authorities routinely over-zone land for redevelopment in order to 'create a market ' in land. This is particularly evident in the Action Plans for smaller towns where, because of scale, the optimum land for development under a five year plan, is often in single or at most a few owners control.

[26] 'Before proceeding it may be a source of some encouragement to consider a selection of comments from Nobel prize winning economists on the efficacy of land value taxation. Interestingly they represent the full spectrum of political ideology from left to right. *Paul Samuelson:* "Pure land rent is in the nature of a 'surplus', which can be taxed heavily without distorting production incentives or efficiency." A site value tax can be called "the useful tax on measured land surplus." *Franco Modigilani:* "It is important that the rent of land be retained as a source of government revenue. Some persons who could make excellent use of land would be unable to raise money for the purchase price. Collecting rent annually provides access to land for persons with limited access to credit." *Robert Solow:* "Users of land should not be allowed to acquire rights of indefinite duration for single payments. For efficiency, for adequate revenue and for justice, every user of land should be required to make an annual payment to the local government equal to the current rental value of the land that he or she prevents others from using." *William Vickrey*, "It guarantees that no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity."*Milton Friedman:* "I share your view that taxes would be best placed on the land, and not on improvements." *James Buchanan:* "The landowner who withdraws land from productive use to a purely private use should be required to pay higher, not lower, taxes." School of Philosophy and Economic Science, May 2003, *Report of the All Party Committee on the Constitution on Private Property,* Government Publications

There is already a provision for a *zoning levy* in the 2000 Act under Strategic Development Zones. This section could be amended to allow for an *annual zoning levy* on all zoned land. This levy/rent should be based on the 'value-added' by permission - as for the development levy- but annualized at a fraction of the total. It could be levied annually in a range of 10% of the 'value-added' of planning permission. Again, site value contour maps derived from market transactions of similar land or residual calculations of property sales will provide an assessment base.

It is reasonable that the *zoning levy* would go towards the eventual payment of the development levy i.e. the development levy would be reduced by the amount paid under the zoning levy. The *zoning levy* would act then as a cash flow or holding cost burden on the landowner/developer not as an extra capital cost *if* the landowner developed the land within the five years of the Development Plan. It would be, none the less, very effective for that as the land would not be generating much by way of income under agricultural use. [27] If the landowner waits for longer than 5 years, the annual *zoning levy* would mount up to more than the *development levy* total and it would then be an extra tax. The *zoning levy* should be a charge against the land; if it is not paid over a period of ten years, the land should revert to the local authority.

The increase of land coming onto the market will reduce house prices, as supply will better meet demand. The actual percentage of 'value-added' of the zoning levies is a political decision for each local authority that should be informed by the market in development land. Zoning levies should be increased where there is a surfeit of zoned land not being developed or offered for sale in a context of local rising house prices.

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[27] 'One argument for a wealth tax (in this case as a possible replacement for income tax) has frequently surfaced in relation to land. If land is left idle or not utilised to its potential, the user attracts no penalty under an income tax. Under a tax applying to the capital value of the land, however, there is an incentive to use the land productively.' (P 86) . Bristow J, Taxation in Ireland : An Economist Perspective, 2004, Institute of Public Administration, Dublin, ISBN No. 1904541054

It is likely that many landowners will ask their land to be de-zoned when faced with a levy. If the land is not prime i.e. well located in relation to roads, drainage, and other services and needed for development within the period of the Development Plan, the request should be positively considered. But the landowner should be given no expectation that his land would be zoned again later. Over time, *zoning levies* will produce higher densities and less wasteful layouts resulting in less agricultural land-take and more compact settlements.

Some landowners may never wish to develop their lands for personal, ecological or historical reasons. In that case, if the land is not critical to the coherent and sustainable development of the area, the zoning levy could be foregone. But the owner must also forego all future development rights in favour of the local authority or other local trust. In the US, where planning control is limited and land/ property taxes enforced, Land Trusts buy future development rights from dedicated traditional farmers so that farming can continue in high land value areas near towns. Community Land Trusts could play a somewhat similar role in Ireland; conserving land from development and managing important habitats or historic landscapes for the benefit of the local community and local environment.

Rural areas that are poorly serviced with good transport links and services would pay a lower *development levy* than towns and cities that have high site values because of their convenience to services and amenities. This is inherently and automatically fairer than the inflexible current system, which has produced a bewildering array of levies for different situations under each local authority that will nevertheless generate anomalies. This system of assessment also works for sites that have been developed already with existing buildings. If the 'value-added' to the site with a new planning permission for a new use or intensification of an existing use is greater than its value in its current use, then it is likely a *development levy* would be due. However, for most planning permission for simple extensions or improvements to buildings, the levy would not be triggered, as the increase in value in the property would be due entirely to the building works.

Probably the greatest advantage of a ‘value-added’ levy system is that it would provide essential information to the local authority, through the land and property market, about the effectiveness of their infrastructure and development decisions. Good planning and well-timed infrastructure and amenities investment would be reflected in higher land values. Levy payers will be happier - no one is completely happy to pay tax - when they see that high ‘value-added’ by local authorities is reflected in their sales prices. Some local authorities will opt for low levies and consequently low infrastructure investment- others the opposite. It would not take long before feedback will emerge indicating what percentage of value -added is optimum and which local authorities are most successful in creating value for both themselves and their residents. It should be self-evident that the central state grant should not make up the shortfall of investment in low levy councils for this balancing mechanism to operate.

With an effective zoning levy in place, planners would be free to zone only such land as is optimal for village or town expansion. Landowners would immediately cease their lobbying for designation unless they truly intend to develop immediately. The numbers of ‘planning consultant’s, auctioneers, and solicitors putting themselves forward for local election might well see a precipitous decline. Corruption in the planning system of local government would be immensely discouraged and consideration could confidently be given to expanding its realm of powers and functions.

Rental charge - Smart taxes or dual commercial rating

The next reform that is necessary to be consistent with our new structure is the reform of commercial rates. Commercial rates have grown to a significant percentage of local government expenditure. As the cost has grown for business, the criticism of aspects of the rating system has grown in parallel. It is perceived as arbitrary and unfair. This arises from the fact that so many other building users are exempt; - not only domestic dwellings but residential investment properties, public property, property occupied by charities and much vacant property. Local authorities have discretion in whether to levy rates for vacant premises and it appears that they frequently remit them entirely in rural areas. Service charges for water and waste collection are also higher for commercial users and are seen, predictably, as double taxation.

A further fundamental bone of contention is that tenants and owners who maintain and improve their property find their rates increased while their negligent neighbours have theirs reduced. The eventual result of this penalization of investment and enterprise is derelict sites and underused properties often in central areas of our cities and towns. The government's response to stimulate development was special tax incentives of generous capital allowances and double rates relief. This cost the taxpayer hundreds of millions in taxes foregone and its effectiveness in stimulating investment that would not have occurred anyway is now, rightly, in question.[28]

In Pennsylvania USA, the response to the same problem of underuse and dereliction was the '*smart tax*' or '*dual rate tax* '. This local tax gradually increased the portion of local property taxes that fell on the site and decreased it on the portion that fell on the building. Thus, at the end of a set period, all local taxes were calculated solely on the value of the site or land under the property. The towns and cities that operate the '*smart tax*' have decreased dereliction, booming business districts, higher tax receipts, and happier taxpayers. The city of Philadelphia is now debating whether to make this change following a campaign led by local businesses and homeowners. The same transition to site value taxes from rates on property should be undertaken in Ireland.

[28] 'It is not known how much revenue is foregone as a result of the accelerated depreciation granted to certain types of construction. What can be said is that there is no evidence that these concessionary schemes of carpark, tourist accommodation, town centres, amongst others) provide any benefit to anyone other than those who are able to avail of them… If this is so, these concessions are simply subsidies to certain developers with no quid pro quo for society.' (P 119, Bristow)

Rental charge - Site value tax (LVT) on public and charitable property

The next reform is to broaden the rate base to cover all public property, which may already be under active consideration by the government. Rates, even in their current imperfect form, are a good mechanism to ensure property resources are used efficiently; and public bodies are probably more at fault than private for 'wasting' their property assets. Although local site value tax receipts on local authority property would return to the levying body, it would act as an invaluable indicator for more realistic internal accounting and more efficient property administration. Similarly, local taxes should be levied on not-for-profits and charities, some of which have very large property portfolios. It has to be recognized that underused sites and derelict and badly maintained properties are both a direct cost in terms of discouraging adjacent development and investment and an indirect opportunity cost on the local community - no matter who owns them.

Rental charge - Second home land value tax (LVT)

Other exemptions to local taxes which are obviously unfair and for which there is considerable support for change are some of the exemptions for residential uses. The reasoning for the exemption of residential property from rates in 1978 was that the owners or their tenants already paid for services through their income taxes. That might have been largely true at the time but it is not true now. Many people now own more than their principal dwelling. Recent research threw up the astonishing fact that a full one third of all housing units built over the last five years are second or replacement dwellings.[29] This means that a substantial number of houses and flats are not occupied on a continuous basis - they are holiday houses in rural areas or pied-a-terres in the city. Some rural counties have very high numbers of these mostly empty properties, which enjoy equal connection to local services but give no return to the local economy in terms of spending power. Many of these second homes are in areas of

[29] ESRI Evaluation of NDP 2003

high scenic amenity where young locals have been priced out of the market. Broad agreement could be easily generated to require those who enjoy the privilege of a second home to contribute to the local community through a local tax. For convenience of assessing and for the other reasons put forward of efficiency and fairness this tax should be based on site value.

Rental charge - Farm LVT

Rates on farms were abolished following a legal challenge to the basis of the valuation of the land and buildings. As domestic rates had just been abolished to popular acclaim there was no political support for a proper revaluation of land to put farm rates on a sound footing. We know far more now of the costs of this omission. It should be seriously considered again in the light of the high costs of collection and low returns of income tax from farmers (an average €1,300 per farmer) and the low turnover and high price of farmland. Duncan Pickard, a farmer in Scotland makes a compelling case for reform

> *The annual total cost to farmers is of the same order of magnitude as the amounts of subsidy paid or the total Net Farm Income, but the effective burden of taxation on farming – the losses imposed because of the way in which government raises revenue (rather than how much it raises) – is crippling. Would it not be more sensible to try to stem this flow by advocating tax reform than to persist in pleading for increases to subsidies?*[30]

[30] Pickard, Duncan, 2004, *Lie of the Land,* land Research Trust and Shepeard Walwyn Ltd, London, ISBN 0956832278

High land costs prevent entry of new farmers with energy, imagination and appreciation of a rural lifestyle. Organic, low energy and diversified farming supplemented by other rural enterprises including renewable energy generation is the model showing most sustainability given the end of cheap oil.[31] Both the traditional family farmer and the green 'downshifter' fit this model and both would be supported by an appropriate tax system based on the quality of the land.

Years of research by Teagasc on land quality, combined with data generated by Coillte, Bord na Mona, the Heritage Council etc could be quickly inputted into GIS maps to update the original Griffith's land valuation. Buildings would not be included in the valuation, as per the reformed commercial and residential LVT. A *farm LVT* should be offered to farmers firstly, as an alternative to the accounts and income tax system. No further tax should be levied on the farming enterprise if the farm LVT option is taken. Many farmers would happily fire their accountants and opt for LVT. When the bugs are ironed out and its fairness is evident to all, LVT should be applied to all farmland. This would favour genuinely efficient farmers with low external inputs and would help reduce the price of farmland to allow new entrants and competition on an equal basis.

[31] 'The alternative to intensive agriculture is integrated mixed farming that maximizes the natural capital of the land, ensuring that nothing is wasted and external environmental costs are absorbed and accounted for. The mainstream farming we have come to think of as the norm over the last half-century may be seen as an experiment from which we have learnt much, but at too high a price. The integrated farm which is the alternative enshrines all the best values of rural landscape and community, and it is sustainable: whether it functions in an increasingly sophisticated and educated society, or in one where unforeseen disaster forces us back to basics'. (P.518) Feehan, John, *Farming in Ireland*, 2003, Faculty of Agriculture UCD, ISBN 1902277597

A *farm LVT* would also provide a framework for a new legitimacy for EU payments to farmers with 'de-coupling' from production. The community could see that it was getting a portion of the value of the payments with the farmer's primary role changing from that of food producer to steward or custodian of the land on their behalf. A *Farm LVT* on farmland would also provide a fair framework for restrictions on use under environmental conservation designations. Farmland comprising high scenic views and/or with bio-diversity under use restrictions gives a lessor use value to the private owner but a higher use value to the community. Therefore the *farm LVT* paid by the owner to the community should be substantially reduced if not relieved altogether. Under this scenario, farmers would actively care for the environment and some landowners might even campaign to have their area designated.

Land value tax (LVT) on all residential dwellings

Undoing the damage to local government finance, democracy, and effectiveness of the 1978 abolition of local taxes on residential property is an absolutely necessary but delicate task. To succeed, it must be made completely clear at the outset that what is proposed is NOT an extra tax but a TAX SHIFT from income and other counterproductive and unfair taxes. In this respect, the tax reform outlined here will not generate a net gain to public revenue as a whole but represents a redirection of taxes from the central exchequer to those of local authorities. It should be attempted only when the other reforms listed above of the *development levy*, the *smart commercial tax* and *second home tax* and *farm LVT* have been carried out and their benefits have clearly been felt. When the benefits are felt, the intrinsic equity and efficiency of taxes on land and other natural resource will be much more easily understood. A LVT on residential properties can solve our single most pressing economic and social problem – that of the lack of affordability of housing in all sectors.

> *In Ireland, one of the reasons why it is expensive to buy a house is that it is cheap to own one, there being no property*

> *taxes (rates) on residences and the exchequer (or, rather, taxpayers who do not have a mortgage) pays some of the interest relief. This subsidized ownership raises the demand for housing, to the benefit of builders, landowners and mortgage lenders.* [32] *(P 118, Bristow)*

Introduction of the residential land value tax (LVT) should be carefully managed in stages. At first, for all existing homeowners the LVT should be allowed as a 100% credit against income tax. In other words the taxpayer's income tax bill should be reduced by the amount she pays in site value tax so no extra tax is paid over and above what is paid at present. However, when there is a property transfer; when the house is sold on or a new house is built and sold, the LVT should not be allowed as a credit against income tax but it becomes an extra tax. This fact should be well advertised in advance so by the time it is introduced the prospective buyers of a new or second hand house would factor it in (capitalize it at a multiple of the tax) and pay less for the house. And in the same way, the prospective developer will have factored in LVT when he estimates the price he can pay for development land. Thus, the LVT would be offset against a lower price for the house- for most, in lower mortgage repayments. With LVT, the local authority will benefit from economic growth through increases in LVT instead of the banks through increases in mortgage lending.[33] In this second scenario that follows a property transaction, we have to rely on the government to make good the promise to reduce income and other unfair taxes as the buoyant receipts from LVT in all its forms reduces the grant necessary from the central exchequer.

32 Bristow, J, Taxation in Ireland : An Economist Perspective, 2004, Institute of Public Administration, Dublin, ISBN No. 1904541054

33 Dr Diarmuid O Grada MIPI , Some hidden Costs of Rural Housing, IPI Conference 2004

One section of the population who will be negatively affected by the LVT are senior citizens dependant on fixed incomes. In many cases, senior citizens live in large valuable houses but have modest pensions. The LVT will act to persuade older people to trade down to housing with better fit to their reducing incomes and will free up larger houses for growing families. But this general social benefit is not so great that we should overlook the personal hardship it could cause for older citizens. A derogation for the very old – over 80 years- and infirm is called for in the early years of the measure so that people are given plenty of time to plan their affairs when they are fit and well. Secondly, the LVT payment could be postponed to add up as a charge on the property when it is sold or transferred in inheritance.

The effect of the LVT will be to restrain and then gradually reduce the price of housing. It will be easier for new entrants to the market to buy a house of their own because their deposit and their borrowing commitment will be less. Income taxes should be reduced as LVT receipts kick in and this reduction of the cost of labour should stimulate job creation. On the other hand, property will become less attractive as an investment because the owner will no longer benefit from unearned rises in land values. This is a good thing as Irish people rely dangerously on property for their retirement income and would be better served by diversifying into pensions and company shares, especially capital in renewable energy.

The local authority should raise the LVT to remove any further increase in land values following careful examination of market information every year. Increases in the cost of building because of inflation in labour or energy costs should not be taxed. It is an easy matter for a skilled quantity surveyor to extract the cost of the building and site from the overall value of the property.

A fall in house values is very likely whether or not LVTs are introduced, as the market is very vulnerable at present to external economic shocks. The rising oil and gas prices due to oil peak and Middle East political turmoil is such a likely shock. Increased costs, reduced sales, and profits will bring lower salaries and redundancies affecting housing demand and prices will drop. Without LVT on zoned land, rather than accept lower profits, development landowners would simply withdraw land from the market; developers would stop building, which would further reduce employment in the construction sector and precipitate an economic depression. The annual housing need of approximately 55,000 units per annum does not reduce however, as it is based on demographics of household formation - but it would not be met. Homelessness would compound joblessness. LVTs will ensure that that housing need is met at all times as it imposes considerable holding costs on ripe development land. Development landowners would be forced to sell at the lower price – a price that people can pay. Construction activity would continue and depression averted.

LVT is essentially *progressive tax* in that those with valuable large sites will have to pay more than those whose house is on a modest site. Apartment owners will pay considerably less under a site value tax regime than house owners will as their site is shared with a number of other apartments. Well-located city householders will pay more than remote village householders will even if they have similar sized houses. The age and condition of buildings would not have to be assessed.

LVT is an *easily assessed* and updated tax - once the initial site value contour maps have been prepared. As outlined earlier, new GIS technology has transformed site valuation exercises to make it perhaps the easiest and most transparent taxation basis currently available. A whole profession of ‘Valuation Surveyors’ already exists well capable of the work.

LVT is an *unavoidable* tax. Site owners cannot up and remove their site to the Caymen islands. It is a tax on location or connection as described before – or a rent for access to public and private infrastructure, services, and amenities. Income and profit taxes can act to discourage employment and investment; - an unfortunate fact that is not useful to deny. Governments therefore, are loath to raise the tax rate on higher earners and are impelled to provide tax reliefs for various kinds of activities it sees as socially beneficial- pensions for instance or urban renewal as discussed before. The sum total of these reliefs is that the high earners pay a far lower percentage of their earnings on average than the tax bands would indicate. Poorer people cannot take advantage of tax reliefs and exemptions because they need all of their income for day-to-day living. However, LVT brings land into production rather than discourages it so there is no reason not to levy at high rate or to give special exemptions. This is what make it fair despite the fact is has no regard to income.

A residential LVT *reduces the use charges* for water and waste. This is because much of the capital cost of providing water and waste services would be covered by the LVT and therefore would be borne by a much greater extent than use charges alone, by the propertied classes. Use charges then would simply ration the resources within their sustainable limits; - see more below.

User charges – carbon energy, water and waste charges

As explained earlier, user charges are an essential part of a package to recoup ‘value-added’ by publicly provided infrastructure and to share natural resources fairly and sustainably. Telecom service providers charge user fees when there is a limit to the capacity of the system, to allocate capacity efficiently and to prevent the system breaking down. User charges are also necessary to manage the capacity of the earth to absorb wastes. But where it might be reasonable for telecom providers to let ability to pay allocate use of the telecom resources or for local authorities to allocate road space through congestion charges or public transport through ticket sales, it is not reasonable to rely on such a crude system to allocate essential life support resources.

Every human being has an equal FREE right to a sustainable quota of natural resources. In the case of Irish citizen and essential resources, this principle translates into a free quota of water and waste services.

This does not equate to endless absolutely free services because once one's fair quota is used up, further use takes from the quota of others already living or yet to be born. It will take some time to reduce as our entire industrial society consumes natural capital as income and regards environmental pollution as an externality, to sustainable levels. The adjustment should not be borne only by consumers but it should be borne equally, if not more so, by producers. A start should be made with setting an annual quota for water and waste for every citizen based on what is achievable by a careful family of modest means. There should be charges for use over the quota or extra quota should have to be bought. The quota should be reduced every year until eventually; a sustainable level is reached. See also Richard Douthwaite's paper in this publication.

Part V Reforms

Society through the state accepts that access to essential natural resources and services are a fundamental right of every citizen. It is costly to provide many of these services to remote rural areas but society, recognizing the need for agricultural production and environmental stewardship, has always been willing to absorb the extra costs. So for instance, local authorities provide water schemes and waste treatment and government agencies provide free school buses, subsidized postal services, social and health services to remote farm families.[34] However, the quid pro quo is altered where the remote dwelling residents do not provide a service to the community which requires their presence there but still expect their services to be subsidized by the general tax payer – typically living in compact town settlements. Many of the 30% plus one-off houses being built annually in the open countryside fall under this category of free riders within the system.

[34] Comhar, Recommendations for Village Development 2004, Discussion Paper

One-off houses benefit from a further free ride in that they are not required to contribute to housing and social cohesion under Part V of the 2000 Planning Act.[35] This requires that housing development landowners pass approximately 15% of the value of their land in kind or in cash to the local authority to help it provide affordable and social housing. However, it only applies to sites containing five or more houses so by definition one-off houses are exempt. The loss of Part V to a local authority is very significant in many rural counties where single one-off housing may constitute up to 70% of all housing developments. There can be no explanation for the exception made for rural housing except that it conforms to historical precedence described earlier, to favour rural landowners over their urban brethren.

Free riders fundamentally threaten the system itself as studies show that other contributing participants will refuse to participate within a system, even where they suffer personally, to punish free riders. Ireland is no longer a predominately rural, farming electorate and the continuance of such blatantly unfair and discriminatory policies has the potential to undermine the planning system itself. The discrepancy in how the aspiring house owner in rural areas is treated under planning and fiscal policy compared to urban aspiring house owner will not be fully redressed under the residential LVT proposed above and further reform is necessary. For starters, all housing should come under Part V. Secondly, the extra-over costs of providing services to remote non-farming residents should be capitalized and charged up front as an additional contribution. Thirdly, the extra over social exclusion costs that the remote dweller imposes on village, town and city dwellers should also be reflected in a further charge. As a general guide, we recommend that remote, non farming house builders should make at least a 30% contribution under Part V; - this is additional to the *development levy*.

35 Feehan, John, *Farming in Ireland*, 2003, Faculty of Agriculture UCD, ISBN 1902277597

A further example of an anti-sustainability tax is the annual car tax as it is not related to a use of a scarce natural resource – oil, or a sometimes-scarce man made resource – road capacity. Even more perverse is the fact that annual car tax receipts are ring-fenced for the local authority block grant, which gives local authorities a stake in high numbers of and continued use of the private car.

5. The land struggle revisited

I have set out a stall arguing for a 'tax shift' from taxes on human labour, profits, transactions and capital with redistribution based on charity to taxes on natural resource use with redistribution based on equity. I outlined how simple amendments to existing legislation, reform of existing taxes, and the extension of others can quickly put these ideas into practice. As the benefits of these changes feed through into political consciousness, the final paradigm shift to a universal Land Value Tax, at least for local government, will seem eminently achievable. Let us now check these reforms against the demands of the historic land struggle – the three Fs. For the purposes of our exercise, the 21st century democratic state replaces the 19th Century landlord ruling class.

Fair rent becomes a Land Value Tax that recognizes the social nature of ownership of land and common resources. This LVT returns to the community the value it has created by legal recognition and protection of land title; by the infrastructure and services connected to it and by the investment and enterprise of its citizens. It fairly allocates that value back to its creators, to the central state, to local government and especially to its citizens. The LVT will be set democratically, according to the economic conditions of the day, so it will be fair by definition.

Fixity of Tenure becomes a guarantee to landowners that they 'have what they hold' without fear of arbitrary dispossession. They have the right to the benefits of the existing use of their land subject to payment of a fair LVT. Compulsory purchase will never be used as a routine method to meet housing or other social aims but only as a mechanism of last resort and with proper legal safeguards. The specter of the land Commission and Kenny Report should be finally exorcised.

Free Sale becomes the freedom to enjoy or sell the property that they have created by their individual work, creativity, risk, and capital investment. This means that buildings and physical improvements to the land should ***not*** be taxed. It also strongly suggests that taxes on income or on sales of manufactured property should be relieved.

I will leave the last words to John Feehan

> *When the particular identity most of us inherited was taking shape in the later 19th century, affinity with the land was at the heart of it. Perhaps this is an opportune time to look back at the ideals that shaped that evolving modern Irish sense of identity. If we can recover it and bring it to fruition it perhaps never fully attained in the past, perhaps we may be able to shape it to an authentic mode of bioregionalism appropriate to Ireland: authentic in the way it is grounded in tradition, but fuelled by the advances and insights of modern ecology and modern agricultural principles of sustainability and environmental responsibility.*[36] *(Feehan, John, P. 526)*

[36] Feehan, John, Farming in Ireland, 2003, Faculty of Agriculture UCD, ISBN 1902277597

2.2

Corporation Tax: Leading the Race to the Bottom

Paul Sweeney

In some quarters, to speak against the low rate of corporation tax (CT) in Ireland is almost to speak treason. There is a riveting hostility to any Irish person who is against the low tax on corporations in Ireland. It is tantamount to being against the national interest. Merging the corporate interest with the national, is of course, very advantageous for the beneficiaries.

This paper, far from treasonable, is based in a realistic assessment of Ireland in the European Union, in a globalised world. It will argue that the rate of corporation tax in Ireland is too low, that it is inequitable, that it is an artificial state aid to business, that it is distracting policymakers from focusing on key industrial policy objectives, that it is a substantial subsidy to the uncompetitive non-trading sector, that it has really alienated our fellow Europeans and especially, that it is unsustainable.

The reduction of the rate to such a low level of only 12.5 per cent was a major policy mistake because:

- An industrial/development policy which is based on artificial tax subsidies is not sustainable.
- It has Ireland leading the *race to the bottom*[1] in Europe, a race which cannot be won by any state.
- It has limited time left and state agencies, instead of promoting it, should be planning its replacement with policies based on real competitive advantage.
- It is unfair to other taxpayers, especially the PAYE sector.

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1 The Race to the Bottom is when sovereign governments compete to attract mobile foreign direct investment (FDI) by reducing corporate taxes, by reducing health and safety regulations, by reducing labour protection standards, by reducing environmental standards etc,

- It has been of immense benefit to the highly profitable banks and other financial institutions where there is limited domestic competition.
- It has also been of unexpected benefit to the other non-trading sectors of the economy from distribution to private services - being a bonus on high profits from the lack of competition in many of these sectors.
- It is also called "Fiscal Dumping" in Europe, alienates our fellow Union member states and has already burnt-up much goodwill towards Ireland.

A Brief history

As a laggard in Europe which Ireland was for many years - not converging until the early 1990s, we did everything we could to attract Foreign Direct Investment (FDI), with a corporation tax rate of 0 per cent on exports, plus large grants, subsidies and heavy state interventionist support for industry. Then, while we had a standard rate of CT of 50 per cent, we also had a 10 per cent rate on manufacturing and then on exported services. While the standard rate had been as high as 50 per cent of profits (see Table 1 below), with a myriad of allowances, few companies paid anywhere near that rate, in effect. Governments decided to reduce the nominal rate and also eliminate many allowances, bringing the nominal and effective rates closer together. This makes economic sense. Mr McCreevy did abolish many of the exemptions, but then decided to retain quite a number of them, particularly those which are based on property and he introduced a few new ones. It may be a coincidence that the property based loopholes are the ones which benefit "persons of high net worth." [2]

[2] A study by the Revenue Commissioners showed that a number of the highest earners in Ireland pay little or no income tax, largely due to the property based tax loopholes.

Table 1 The Reductions in Irish Corporation Tax Rate*

1976	50	1997	36
1977-81	45	1998	32
1982-88	50	1999	28
1988-89	47	2000	24
1989-91	43	2001	20
1991-95	40	2002	16
1995-97	38	2003 et seq.	12.5

**Standard rate* *Source: Revenue Commissioners*

The European Union was unhappy with a low a rate of only 10 per cent for manufacturing while the standard rate of CT for companies in other sectors was higher. It ruled that this was discriminatory. The government responded to the EU ruling by proposing to cut the standard rate for all companies to just 12.5 per cent. This reduction was recommended by a Forfas advisory board[3] but was opposed by the Department of Finance who believed the rate proposed was too low.

The Rainbow government decided to bring down the rate of CT progressively. It was 38 per cent when it took the decision and it decided to reduce it to only 12.5 per cent. This was implemented by the next government, reaching 12.5 per cent in 2003[4]. This reduction in taxes was probably the most planned reduction and tax "reform" ever undertaken in Ireland. Yet it was without real coherent strategy. It was a huge unexpected tax subsidy to businesses, especially the financial institutions and to those in the non-trading sectors. No quid pro quo whatsoever was requested in return by either government. It was argued by proponents that it was a rise for those on the 10 per cent rate, but this was delayed until 2005 for services and 2010 for all exiting manufacturers.

[3] The Forfas Finance and Taxation Advisory Group. The author was a member of this group, largely composed of industry representatives, i.e. beneficiaries of the low tax rates. It was not unanimous in this recommendation.

[4] There is a corporation tax rate of 25 per cent on non-trading income, on mining and oil and gas companies (royalties on production were abolished some years ago).

The Low Rate - a State Aid to Industry?

The IDA, the state industrial promotion board which is very successful in attracting Foreign Direct Investment (FDI) to Ireland highlights Ireland's low taxes on corporates as a major selling point for the country. In a recent publication[5] it emphasises Ireland's low rate of CT, but it can be inferred from Table 2 that there appears to be an implicit warning that the new accession countries' rates may be a threat, as their rates are almost as low.

Table 2 2004 Corporation Tax Rates

	%age		%age
Ireland	12.5	Poland	19
UK	30	Latvia	15
Belgium	33.99	Lithuania	15
France	33.33	Hungary	16
Netherlands	34.5	Luxembourg	22.9
Spain	35	Portugal	25
Austria	34	Slovenia	25
Germany	26.4	Italy	26
Czech Rep	28	Denmark	33

Source IDA, 2004

Table 3 below, shows how Ireland's rate gives companies an effective subsidy compared to companies located in other countries.

Table 3 %age Increase in Profit required to achieve the same distributable Income available in Ireland

UK	25	US	45
Belgium	33	Germany	46
France	33	Estonia	18.2
Netherlands	34	Cyprus	2.9
Spain	35		

Source IDA, 2004

5 IDA, July 2004, Ireland, Knowledge is Our Nature, Dublin.

Table 3, from the same IDA document, demonstrates clearly that the low tax is a subsidy to international mobile business and to all domestic businesses, including incorporated services. It explicitly states that, for example, a US based firm has to achieve an additional profit of 45 per cent to compete with one based in Ireland to achieve the same distributable income. Similarly one based in Germany has to make an additional profit of 46 per cent, though one in Cyprus has only to boost profit by 2.9 per cent. Cyprus just joined the Union. The threat is implicit. We are being pursued by the new members on the tax competition race to the bottom. Estonia, with a rate of 26 per cent in the table, actually has a rate of zero for many firms. This will be hard to compete with. Of course, we could compete by offering negative rates of corporation tax, that is grants and subsidies[6].

From Table 3 we can compute the tax subsidy to corporates. For example, AIB made a net pre-tax profit of €1,011 million last year. The low tax rate in Ireland means that if the bank was located in the US, it would have to make a net profit of €1,466 million to be as profitable as an Irish based company. There is an implicit tax subsidy to AIB of 45 per cent, as the IDA shows, or €455m in cash. When this is applied to all companies in Ireland, it would appear as if we are losing out substantially, but of course, this is not the case. This is just an example to illustrate that there is an implicit tax subsidy to business which is located here. The losses in Exchequer revenue, from the tens of thousands of non-trading companies which are the chief beneficiaries of the low tax regime, may probably be made up by the transfer-pricing revenue from the multinational companies (MNCs). The estimate of the aggregate gain or loss is not possible to make.

[6] GDP is the international comparitor between countries and Ireland's is artificially high largely because of Transfer Price Fixing. The better measure is GNP. GDP is 20 per cent above GNP in 2004,, largely because of TFP.

Why Taxation?

Taxes are levied for three reasons:

1. To raise revenue to run the state.
2. to redistribute income and wealth.
3. to encourage favoured economic activity.

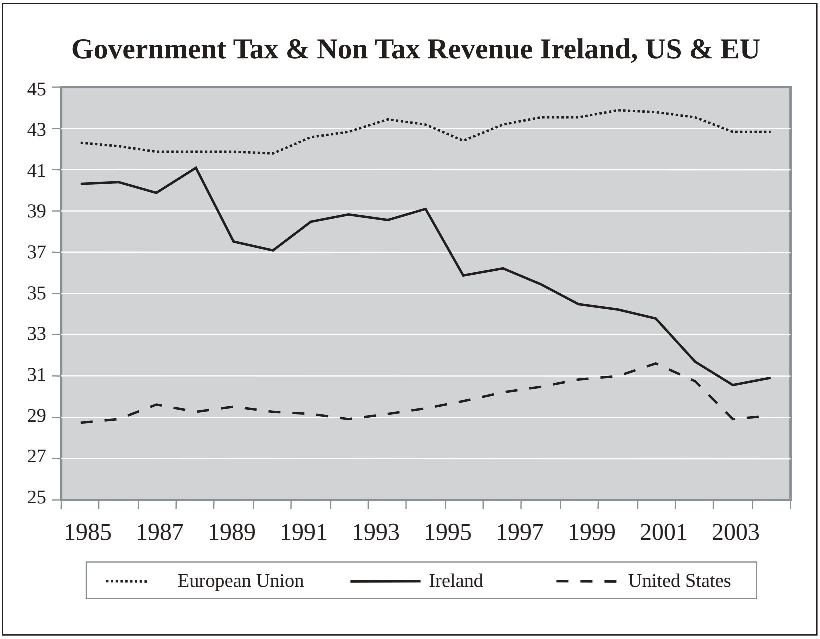
In Ireland we have been obsessed with the third objective. There has been very good reason - we needed economic activity and jobs. It is still not an objective which we should lose sight of. However, the government and many others have lost sight of the first two objectives. Many changes in the tax regime in Ireland in recent years have not been progressive (with some exceptions such as tax credits) and the low tax regime is part of the regressive and inequitable policies. It will be seen that the low rate of CT has, so far, not led to less revenue (the first objective), largely because high profits, the economic boom, the increased numbers of MNCs and other companies in Ireland and because we have benefited from Transfer Price Fixing (TFP – where MNC switch profits into low tax countries).

On total tax revenue, however, Figure 1 shows very clearly that Ireland has decidedly moved away from Berlin to Boston, following the US model, as users for our poor quality public services, our schools, hospitals and public transport will know.

First Mover Advantage

Ireland has benefited from the low rates of corporation tax. It has had “first mover advantage” in the area, attracting companies who wish to minimise their tax burden. In addition, Ireland attracted “profits” into Ireland which were not made here and was able to take some tax off them, to the benefit of the Exchequer. Multinational companies (MNC) can locate profits where they like through transfer price fixing (TFP) and many still locate profits here to take advantage of the low tax rates. This is, however, not popular with other countries who lose tax revenue both to Ireland and to the companies in higher retained profits. Nonetheless, it has to be said that that the low tax regime did bring jobs to Ireland in foreign direct investment (FDI) and gains for the Exchequer which were not earned here.

Figure 1



Sources: National Income Accounts and European Economy

This year, tens of millions of profits will be located in Ireland, artificially boosting our GDP and making us look better than we really are[7]. Ireland does get some benefit from this in taxation. So the low taxes on companies did help attract FDI and jobs to Ireland.

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[7] Irish Times, 17th September 2004.

But the Writing is on the Wall

Ireland is the most profitable country in the world for US corporations, a detailed analysis of global tax havens has found[8]. The analysis, in the influential US tax journal *Tax Notes*, found that profits made by US companies in Ireland doubled from 1999 to 2002, while profits in most of the rest of Europe plunged. The report found a huge shift in the movement of capital towards tax havens. "In low-tax Ireland, for instance, profits of subsidiaries of US multinationals have doubled in four years, from $13.4 billion to $26.8 billion. Profits from operations of US multinationals in no-tax Bermuda have tripled, from $8.5 billion to $25.2 billion. Not surprisingly, those two *tax havens* rank as the number one and number two locations in terms of profitability for US corporations operating abroad" (my emphasis). The Irish Times quoted a Washington Times columnist and former Reagan administration economic policy official, Mr. Bruce Bartlett, as saying that US tax laws needed to be rewritten to stop American companies from receiving tax credit for profits earned and held abroad.

Even the conservative think-tank, the OECD, is against tax competition. It says that, on the issue of taxation, Governments can respond to the challenge of globalisation in one of three ways. They can retreat behind national frontiers and try to move back towards an "isolationist" approach to global tax issues. The second option is to press for a harmonisation of the international tax system: a sort of global tax code administrated by a global tax authority. And third, they can respond by intensifying their co-operation, which includes putting in place transparent systems and sharing information across borders.

It concludes that intensifying co-operation is the only appropriate response to the pressures of globalisation. National governments maintain their power to design their tax systems, but accept that these decisions will be influenced by international considerations. It also means that they must carefully consider how their decisions will affect

[8] Jeffrey Owens, Head of Tax OECD, in OECD Observer, March, 2002, Paris.

the ability of other countries to enforce their own tax laws”[9]. Further, the OECD has no less than five times cited Ireland for “potentially harmful tax practices”. The government took comfort from the use of the word “potentially”[10].

Therefore the writing is on the wall from the US as well as from our European colleagues on Ireland’s status as a corporate tax haven. Policy makers who ignore the clear signs are the ones who are guilty of self-deception and are not acting in Ireland’s interest (treason is too strong a word!).

Voodoo Economics

The amount of corporation tax has grown even with the reduction in tax rates. This idea of tax cuts leading to increases in tax revenue, expounded by Ronald Reagan in 1980, was called *Voodoo Economics*, by no less a person than his Vice President, George Bush Snr[11]. Remarkably, Voodoo Economics *appeared* to work for Ireland. Tax revenue grew from companies in the 1990s as the tax rates were reduced.

Of course, the reality is more complex. Corporation Taxes grew, first, because there was an extraordinary economic boom, the Celtic Tiger, (which is most graphically illustrated by Figure 2, which shows the growth in employment).

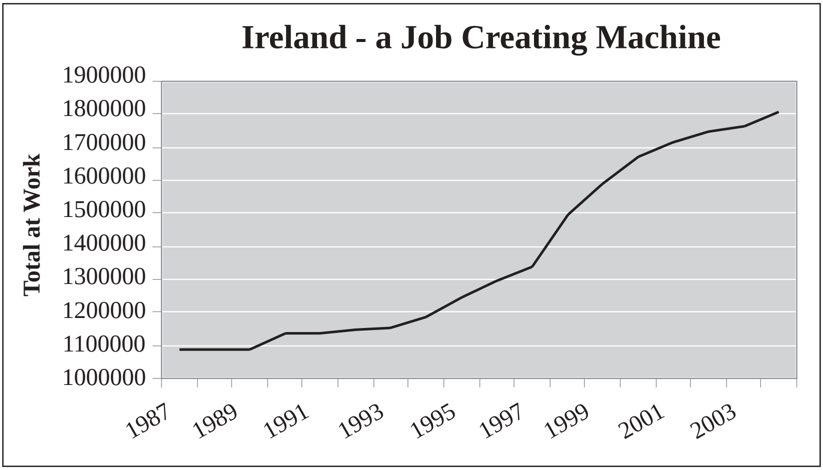
Secondly, it grew because profit levels soared as illustrated in Figure 3, which shows that overall profits soared to remarkable levels at one stage in the late 1990s - to almost 30 per cent. While they fell and were briefly negative in 2003, they are rising again to reasonably high rates, as the Chart shows.

9 Irish Times 27 June 2000.

10 Stiglitz, Joseph, 2003. The Roaring Nineties, Penguin. This is an excellent readable book on the US economy today and on the economic fads which often lead to pain for the little people.

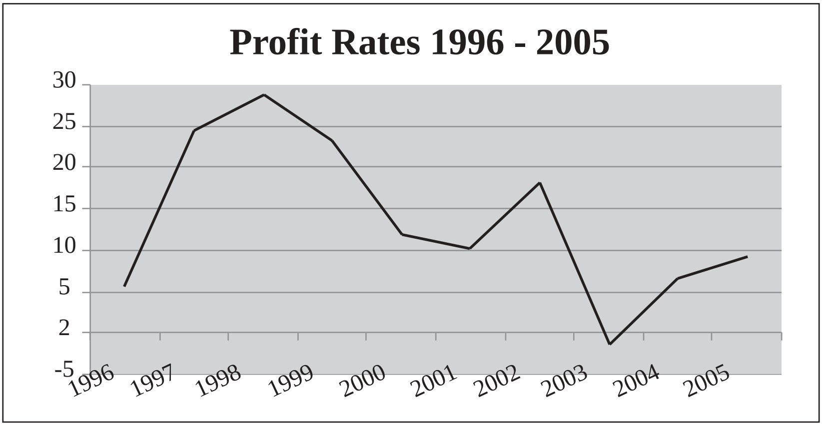
11 Irish Times 13 September 2004.

Figure 2



Source: CSO.

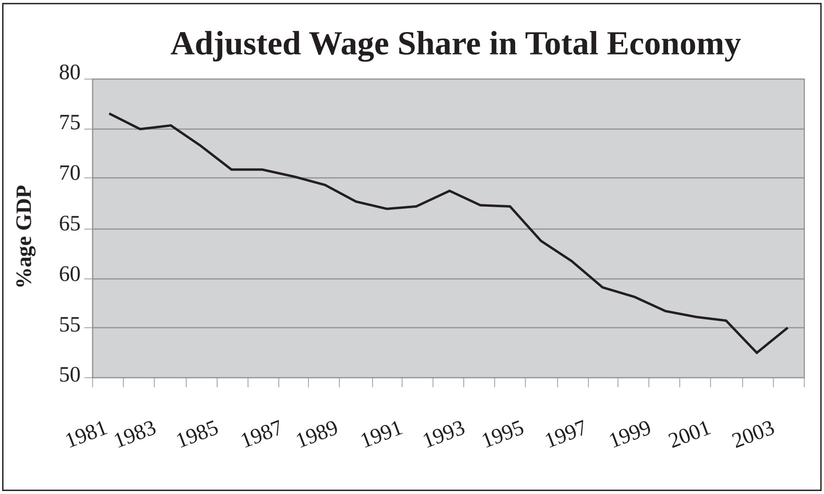
Figure 3



Sources: National Income Accounts and ESRI.

Furthermore, profit levels rose because national income shifted dramatically from wages to profits (see Figure 4), which was driven by other factors, such as wage moderation under the national agreements, and companies did shift profits artificially into Ireland to take advantage of low taxes on companies, (just as easily as they will shift them out to countries with a zero rate).

Figure 4



Source: National Income Accounts.

Corporation Taxes

Workers are taxed at 42 per cent of their income plus PRSI of 6 per cent - giving a marginal take for the state of 48 per cent. On the other hand, companies and incorporated professionals pay 12.5 per cent maximum on their profits. There is an argument which some make which is that companies should not be taxed at all. It is argued that only individuals in receipt of income from companies in dividends etc. should be taxed. There is a certain logic to this, but the individual owners of the shares of many of the MNCs operating here cannot be taxed here because they live elsewhere. Under this argument, neither can corporate shareholders be taxed. As these companies make use of our roads, infrastructure etc., they should pay a contribution, in addition to rates. Further, the owners of companies are generally the better off people and CT is a way of taking some revenue to pay for the state's services.

The Low CT Rate is Not Sustainable

The low rate of corporation tax in Ireland is not sustainable because even with the cosy consensus among the main political parties, and the beneficiaries, business, it is the European Union which will have to introduce tax co-ordination, or tax harmonisation. If the EU does not deal with tax competition between member states, then it has no future as an economic Union. It is even possible that Mr McCreevy, staunch defender of the low company tax regime in Ireland, will in his new role, come to recognise that the future of the Union is more important than one country's short term advantage.

In September 2004, European Union finance ministers agreed to examine how to harmonise the rules under which corporate tax is calculated throughout the EU. The Irish Government was forced to agree to participate in a working group on the issue, despite its opposition to the proposal[12]. The Minister for Finance, Mr McCreevy, was one of only four out of 25 ministers to express outright opposition to the need for tax co-ordination within the Union. The others were the British of course, and the Maltese and Slovaks. The group will discuss harmonising the tax base, not tax rates, but it will inevitably come in due course.

Just before this decision on an examination of the tax base, the French Finance Minister, M. Nicolas Sarkozy, called for countries that have unusually low corporate tax rates to have their EU structural funds cut. He specifically singled out Ireland because of its low tax regime.

[12] Irish Times 13 September 2004

When Ireland was a poor country and had high unemployment, other European states could tolerate low taxes in a poor member state with only 1 per cent of EU GDP. But things are different today with Irish incomes levels above the average in Europe and low unemployment. M. Sarkozy made the very reasonable argument that if Ireland was unwilling to fund its public services by levying taxes on profitable companies operating here, then it should not get handouts financed by the taxpayers in the rest of Europe. Of course, cutting the Structural Funds is not the way to deal with the issue of tax competition and the race to the bottom.

The Irish Times said that “the issue of corporate tax rates has risen to the top of the French political agenda in recent days, with the former Socialist Prime Minister, Mr Laurent Fabius, threatening to campaign against the EU constitution unless action is taken to prevent French companies relocating to low tax countries in central and eastern Europe.”[13]

In short, tax competition or “fiscal dumping” will lead to a race to the bottom as member states compete to attract FDI with lower and lower corporate taxes, followed by lower labour regulations, followed by lower health and safety regulations.

If the European Union is to have a future, it must have some basic rules on fiscal policy and especially its members tax bases. It must protect the European Social Model. The Commission was already unpopular with the peoples of Europe, but now that it has shifted very much to the Right and decisions like this, which favour business over people, will not help its popularity. If the European Union continues down this path to the bottom on social and fiscal standards, its very future as a Union of 25 states is in jeopardy. It will be a Single Market, without a social or political dimension.

[13] Ibid

The British may be leading the race to the bottom in Europe on most social issues but the Irish are leading in the race to the bottom in tax competition with the 12.5 per cent rate. Estonia has a zero rate for some companies and the Central Europeans will soon get in on the act, following Ireland's lead and surpassing it. This is not good financial governance for Europe, for its peoples and for the Social Model. It is the kind of action which gives globalisation and internationalisation a bad name.

Policymakers Must Replace their Reliance on the Race to the Bottom

The self-deception by policymakers in Ireland, some of them strong Europeans, and their absorption with pure short-term self-interest on the low company tax issue, is disappointing. It is fortunate that Ireland has many real competitive advantages such as the well-educated, English speaking, flexible workforce, access to Europe, clusters of leading companies, etc. Nonetheless the continuing focus on the low rate of CT by Irish policymakers is misplaced.

It seems obvious. The race to the bottom on tax competition cannot be won by any state. Ireland cannot compete with central European states with zero rates of CT, unless we want to bankrupt the country or impose even higher taxes on spending and on low to middle incomes, while we give cash grants and subsidies to business on top of a zero rate of tax.

It was disappointing that the Enterprise Strategy Group Report[14] did not recommend a phasing out of the state's dependency on tax subsidies to business in Ireland. The Group deliberated and consulted widely for a long time and has made many valuable recommendations, but to encourage the state and its agencies to continue to rely on this

[14] Enterprise Strategy Group, 2004, Ahead of the Curve, Forfas.

artificial state aid to business, is very disappointing. Its chairman, Eoin O'Driscoll was made Chairman of Forfas, the government's advisory body on industry and enterprise, on completion of the report, by the Tanaiste, Ms Harney.

A strong argument against the view that the low tax rate is unfair to other taxpayers is that corporation tax receipts have risen to 16 per cent of total taxes in 2004. Corporates are contributing more and we all gain. However, the reasons why the corporate tax take has risen are set out above and companies' share will decline as profits fall, as MNCs shift TFP to even lower tax havens - if there is increasing tax competition and if the share of the Irish national cake becomes more equitably distributed.

Conclusion

Ireland has gained from its "first mover advantage" with its low CT rate which has been of some assistance in attracting MNCs jobs and taxes from transfer-price-fixing (ie profits not generated but located here, at the expense of other countries). However, time is running out and if tax competition or "fiscal dumping" continues, then the European Union itself will have a serious problem. The Union is in danger of being turned into a mere Market, losing its social and political dimensions, and ultimately the support of its peoples. Europe will have to co-ordinate its tax polices within some agreed principles and ranges. Tax competition does not work, except for the beneficiaries. In the age of intensive globalisation, Europe must have tax co-ordination to help impose some international governance on MNCs.

Irish policymakers must shift their focus from the low tax rate to building on our other real competitive advantages, which are fortunately, many.

It is recognised that it is extremely difficult for governments to signal that they are raising the rate of taxes. It could deter some FDI. However, companies which come only for tax breaks will not stick. The move to raise the effective rates of CT can be done by the government agreeing with our fellow member states to have tax co-ordination.

In the meantime, exemptions and loopholes have to be plugged and the both the nominal and effective rates should be brought closer together, but preferably the 12.5 per cent should become a minimum effective rate.

The banks and the non-trading sectors have low levels of competition, which means higher profits than in a competitive environment. As a first step, a levy should be raised on the banks and ways explored to tax super-profits from the sectors where there is weak competition. In time, the standard CT rate should be raised to 20 per cent, in co-ordination with the European Union. This is the same rate as the standard personal rate, and the effective rate should be close to this, with only legitimate capital allowances being deductible.

If the nominal rate of CT is raised to 20 per cent and most tax exemptions reduced, Ireland will still attract FDI; there will be little impact on employment; and the palpable resentment of other European countries against Ireland will be ended. It would mean that Ireland no longer leads the race to the bottom in fiscal dumping.

Ireland is no longer a poor country and we cannot and should not lead the race to the bottom. If Irish policy makers do not move on this issue, it is likely that Europe will. Europe has to protect its future as a political, social and economic Union and not a mere single Market, with weak corporate governance.

2.3

Tax Expenditures, Incentives and PRSI

Colm Rapple

The second phase of an apartment development at Santry Cross, Dublin, was launched onto the market in March 2004 at prices some 15% lower than the prices at which the first phase had been very quickly sold. It was unusual to say the least. House prices were still showing year-on-year increases of over 10% at the time. So why the price cut?

It had nothing to do with location, building standards or any prospective development that might impact on property values in the area. It was solely a reflection of the fact that the first phase had been eligible for Section 23 relief while the second phase wasn't.

Section 23 relief, more properly known as the Urban Renewal Scheme is being phased out. It was to have ended on December 31 next but Finance Minister, Charlie McCreevy, in response to pressure from developers, extended the final closing date to July 31 2006. Developments will continue to benefit from the relief provided 15% of the total project costs were incurred before June 30, 2003. Obviously the Santry development couldn't meet that condition.

The relief provides very valuable tax benefits to investors particularly those with other investment properties and its operation provides a good illustration of the pros and cons of tax incentive schemes. It provides a complete tax write off against rental income in respect of the cost of building the accommodation, sometimes up to about 80% of the price.

The scheme was originally introduced in 1986 with the aim of encouraging urban renewal. At the time Finance Minister Alan Dukes told the Dáil “It is confidently expected that it will quickly lead to a substantial increase in building activity in depressed inner-city areas. In the longer term, it will bring a new vitality to these areas as they are developed.”

It was a laudable objective and there is no doubt that the incentive was successful. Money was invested in building houses and apartments that might otherwise not have been built in the relatively stagnant economy of the time. Construction is a particularly good economic activity to encourage in times of recession. It is labour intensive and makes the maximum use of domestic resources. As an additional benefit there was an increase in the stock of rented accommodation from which we are still benefiting.

No detailed study of the costs and benefits ever seems to have been made. Indeed the Revenue Commissioners are still unable to put even an estimated cost on the scheme in terms of tax foregone. It is likely that for some years the benefits did well outweigh the costs. But the fact that the sums were never done resulted in the scheme long outliving its usefulness.

The balance between costs and benefits is not easy to assess. There is a need to consider:

- How much of the encouraged activity would have taken place without the incentive? In other words how much of the tax relief is going to people who would do what you want them to do without any incentive?
- Is the encouraged activity actually good for society and the economy? Doubts have been cast over the desirability of some of the holiday cottages and seaside developments encouraged by tax reliefs.
- Does the encouraged activity have a negative impact on other areas of the economy? For instance, is it pushing up the price of scarce resources or simply replacing other activities that won’t have the benefit of the same tax reliefs?

- Will the tax relief result in unacceptable inequities in the share out of the tax burden? This may be subjective but perceived inequities can have an adverse effect on economic and social behaviour as real inequities.

At the time it was introduced the Urban Renewal Scheme would have passed all those tests. But for many years landlords have been able to get adequate rents from their tenants to more than reward their investment and any small risk they perceive. The relief has distorted the property market and undoubtedly pushed up prices for owner-occupiers. The 15% price drop in Santry gives an indication of the impact tax concessions can have by artificially stimulating demand from investors.

In a perfect world supply would immediately grow to meet demand but we don't live in a perfect world and the supply of residential property has been lagging far behind demand for many years.

The benefits of the Urban Renewal Scheme are inequitable spread. Those with sizeable rental income can get the full benefit in year one. Investors with only that one property have to spread the benefit over many years.

These flaws and inequities have been evident for many years and not simply in the Urban Renewal Scheme which is being highlighted here simply as an illustration. But politicians and the civil service seem to find it very difficult to monitor past decisions and revise them where necessary. So we continue to have a plethora of tax incentives that cannot be justified on economic grounds.

Many tax expenditure schemes are being phased out but new ones are being introduced. For instance this year Finance Minister Charlie McCreevy introduced a new tax credit to encourage firms to spend more on R&D. Its necessity has been called to question although the Enterprise Strategy Group did point to both R&D and sales and marketing as areas in which the Government could take useful action to help businesses.

Although it hasn't been highlighted our low rate of Corporation Tax could encourage companies to locate major R&D programmes in a higher taxed location than Ireland. Here the cost can only be written off against a 12% tax whereas perhaps in another of its international locations it may be possible to write it off against a far higher tax rate.

That wasn't used as a justification for introducing the new relief but the manner in which it has been introduced suggests that this was a consideration. The concession has been introduced as a tax credit rather than a relief. It provides a tax saving worth 20% of the actual R&D expenditure.

If it does encourage more R&D operations into Ireland it may well be justified but Colm McCarthy of DKM Consultants pointed out in an Irish Times article[1] that no persuasive evidence had been offered to support the assertion in the Enterprise Strategy Group's report that companies spend too little on sales, marketing or R&D. It was as implausible, he suggested, as claiming that they wilfully keep running out of essential raw material stock.

There is certainly room for debate and a clear need for more analysis of the costs and benefits of all our tax expenditures and reliefs. We know what some of them cost but the Department of Finance or the Revenue Commissioners never saw the necessity of even gathering the information from which the cost of others such as the tax exemption on stallion fees could be calculated – not until last year at least and only then under pressure.

We still haven't got all the information and some of what we have is dated.

[1] Irish Times, July 8, 2004.

The latest available figures for the cost of tax reliefs and allowances relate to the tax year 2000/01. They were published late last year in the Revenue Commissioners annual statistical report and were repeated with a few updates in response to a Dáil question in May 2004. A summary of some of these is shown in the accompanying table. (pages 89,90)

EFFECTIVE TAX RATES

Not surprisingly tax incentives are used mainly by high-income earners. Most can only be used by those with money to invest. But the fact that the property investment concessions enable many high earners to greatly reduce their tax liability has been a cause of political concern because of the perceptions of inequity to which it gives rise. In 1997, the Revenue Commissioners carried a study on the Effective Tax Rates for High Earning Individuals based on the tax years 1993/1994 and 1994/1995. Of 400 taxpayers studied for the year 1994/95 the effective tax rates worked out as follows:

Over 45%	33	8.2%
30 to 44%	219	54.7%
less than 30%	123	30.7%
unknown	25	6.2%
Total	400	100.0%

The study concluded that capital allowances on buildings in tax designated areas and on hotels was one of the main methods of reducing the tax bills of high earners to very low levels. The benefits were restricted in the 1998 budget.

In 2002 the Revenue Commissioners repeated the exercise on the basis of the 1999/2000 tax year. Of the top 400 earners’ cases examined in the study, 117 had an effective tax rate of less than 30%; 231 had an effective rate between 30% and 44% and 52 had an effective rate of 45% and higher while 29 cases had an effective rate of zero percent. It was clear that despite the 1998 restrictions many high earners continued to achieve substantial reductions in their tax liability. Property based capital allowances continued to be the major tax saver for the high earners. Many of these are now in the course of being phased out and the Government is now committed to keeping all tax reliefs under review.

As part of the current national agreement "Sustaining Progress" the Government agreed that:

> *"Tax expenditures will be kept under review and will be amended or terminated if necessary in the light of changing economic and social priorities. Government is committed during the lifetime of this Agreement to ongoing review of the scope for widening the tax base, subject to the key national economic, social and environmental principles identified".*

And in response to the Dáil question mentioned above Charlie McCreevy said that

> *"tax based schemes are kept under constant review, especially in the context of the annual budget and Finance Bill process, to ensure they continue to meet the purpose or purposes for which they were introduced."*

If that is the case then some of the remaining reliefs face abolition although maybe we shouldn't hold our breath. Many reliefs are of doubtful economic value. Others are obviously inequitable in their application. The following are some of the more obvious.

PENSIONS

The tax concessions on pension contributions and pension funds cost the Exchequer €2,738 million in the tax year 2000/01. That is made up of a number of elements

Exemption of pension fund income	€ 1,292m
Relief on employers' contributions	€ 645m
Relief on employees' contributions	€ 472m
Self-employed contributions	€ 205m
Exemption of pension lump sums	€ 124m
Total	€ 2,738m

It's worth noting that the total tax foregone was significantly more than the €1,987 million spent on age related social welfare benefits in 2001.

While there may be some justification from a social and economic perspective for encouraging people to save for retirement the concessions could be claimed to have had limited success. They are also skewed very much in favour of the better off who would possibly save for retirement in any case. What else would they do with their spare money but save or invest it.

Using data in the 1998 Living in Ireland Survey and repeating earlier work done by Gerard Hughes the ESRI estimated among those employees in pension schemes almost 44% of the tax relief on employee pension contributions went to the top 10% of earners and the top 30% enjoyed over 80% of the benefit.

The relief on employer and self-employed contributions is undoubtedly even more skewed in favour of the higher paid.

The people who least need the encouragement of tax relief to get them to save for retirement can get tax relief at 42%. Those who do need some encouragement, because they don't have a lot of spare income, only get relief at the 20% standard rate of income tax or don’t qualify for relief at all.

One way of moving towards greater equity and efficiency would be to replace the tax relief on pension contributions with a flat rate contribution from the State. In other words, instead of giving tax relief at the contributor’s top marginal rate of tax, the government would simply top up pension contributions up to a set limit. So it might adds €1 for every €2 put into a pension scheme, in much the same way as the top up on the Special Incentive Savings Scheme works.

SPECIAL SAVINGS INVESTMENT ACCOUNTS

The objective of the SSIA scheme has never been entirely clear although the supposed aim was to encourage saving. A document prepared for the civil service Tax Strategy Group[2] has suggested that “the main benefit of the scheme is that it has encouraged a regular pattern of savings in the context of helping people provide for their future needs”. But there have also been suggestions that the aim was to mop up spending power and thereby reduce inflationary pressures although it was introduced at a time when economic growth was slowing and needing, if anything, a boost.

The SSIA scheme has certainly encouraged regular saving but it is impossible to gauge the extent. Much of the money going into SSIA accounts is undoubtedly being transferred from other savings. Accounts had to be opened between May 2001 and April 30, 2002. They will mature in 2006 and 2007. A total of 1.17m accounts were initially opened.

[2] TSG 03/22

The scheme is estimated to have cost the Exchequer €433m in 2002 and the Department of Finance has estimated the cost in future years as follows:

Year	**Cost**
2003	€517m
2004	€517m
2005	€517m
2006	€446m
2007	€87m

These estimates assume that the level of monthly savings will remain broadly unchanged with some participants increasing their savings and others closing accounts or reducing their monthly contribution. But it is more likely that the net level of savings will increase as the maturity dates get closer. There's a progressive reduction in the length of time that the money has to be left untouched and a progressive increase in the rate of return.

The incentive to save the maximum amount increases greatly as the maturity date gets closer. For example the amount saved in the last month before maturity yields a monthly return of 25% equivalent to about 300% a year.

The gains from the scheme have been very inequitably spread. The take up was very high, about one in three of those eligible, 1.17 million, opened accounts. But that means that two-thirds of the population aren't benefiting at all and not all those who opened accounts are benefiting to the same degree.

By December 2002, about 26,000 had closed their accounts and the average amount going into accounts was €158, well below the maximum of €254. During 2002 only 38% were putting in the maximum amount while 2% were putting in the minimum of €12.50. The inequity is very obvious if we look at the extremes. At one end of the spectrum there are those who couldn't afford to open an SSIA and are gaining nothing. Near the other end are families with two children over 18 who can afford to save the maximum amount in 4 accounts and get a State hand-out of €254 a month.

It now seems likely that in order to minimise the inflationary impact of maturing SSIAs a further tax incentive is being considered.

CHILD BENEFIT

Having made a strong case for taxing Child Benefit in a report last year[3] the National Economic and Social Council concluded

> *"While the Council is aware of major political and constitutional sensitivities attached to bringing child benefit within the tax net; it suggests, nevertheless, that facts concerning the distributional impact of child benefits should be researched and routinely published."*

NESC repeated ESRI estimates that falling unemployment had greatly reduced the number of children living in poverty from about 15% to 8% in 2000. While it may seem small 8% equates to about 90,000 children. That's likely to be an underestimation. During 2003 there were 254,000 children living in households relying on mean's tested social welfare payments for at least part of their income.

Last year some €315 million of potential tax revenue was foregone by exempting child benefit.

[3] NESC, An investment in quality: services, inclusion and enterprise, March 2003

MORTGAGE INTEREST

Mortgage interest relief provides a tax saving of €1,600 a year for married or widowed first time buyers and €1,016 for other owner-occupiers - half of those figures for single taxpayers.

While demand for houses outstrips supply the relief possibly only serves to inflate prices. The availability of the relief increased the amount that home buyers could borrow and that allows sellers to ask for more. But the thresholds haven't been raised for some years. That combined with rising house prices has resulted in the relief being less significant to house-buyers' budgets than it once was. It is effectively being phased out.

Of far greater impact on prices is the tax relief on all the interest paid by house property investors. While it was disallowed for a short time, such interest is once again considered a business expense allowed in full and at the claimant's top marginal rate of tax.

An investor who borrows €300,000 to buy a property to rent out at say 4% can claim annual tax relief of up to €5,040 on the €12,000 annual interest. A married first-time owner-occupier can claim a maximum of €1,600. That clearly distorts the housing market serving to inflate prices.

HEALTH EXPENSES RELIEF

The tax relief on health expenses is allowed at the taxpayer's top marginal rate of tax. It's an allowance rather than a credit and for any given medical expenses is worth a lot more to those paying tax at the top rate. Depending on the person's income it can be worth nothing €20 or €42 for every €100 incurred in approved medical expenses. That's also true of the tax relief granted in respect of wages paid to a carer employed to look after the taxpayer, his or her spouse or an incapacitated person.

PRSI.

The pay related element that originally applied to both contributions and benefits now only applies to contributions and, for employees, only within defined limits. Those on very low incomes are exempt while no employee contributions are paid on that portion of an individual's income above €42,160.

PRSI is a tax. For decades the Social Insurance Fund into which the contributions go was not self-financing and needed to be subsidised from the Exchequer. In recent years the contributions have been more than enough to meet the cost of benefits on a cash-in cash-out basis and some surplus has even been transferred to the Exchequer. So the existence of a separate fund doesn't seem to influence in any way the benefits paid out.

It is difficult to see any reason why the fund should not be subsumed into the Exchequer and PRSI contributions integrated with the tax system. This is not an argument for the complete integration of the social welfare and tax systems. That's a much broader issue. But there is a case to be made for financing social welfare directly from the exchequer and defining PRSI contributions as the tax that they most certainly are.

But as a tax PRSI suffers a number of shortcomings. The low income exemption limits create anomalies and poverty traps while, considered as a tax on employees, PRSI is decidedly progressive. It only applies on incomes between €127 and €42,160. An employee on €200,000 pays the same as a colleague on €43,000.

As a tax on business employers' PRSI discriminates in favour of capital as opposed to labour. This is obvious, for instance we take the case of two companies each making a taxable profit after all reliefs etc of say, €10m. But let's suppose that one employs 200 workers and the other only 100, their total tax bill works out like this with the more labour intensive business paying 26% more tax overall.

	Company with 200 workers	Company with 100 workers
PRSI	€860,000	£430,000
Corporation Tax	€1,200,000	€1,200,000
Total Tax	**€2,060,000**	**€1,630,000**

Assuming average annual earnings of €40,000 per worker in each case.

Over 20 years ago in 1982 the Commission on Taxation proposed a flat rate social security tax on all income both that of individuals and companies. This approach was rejected by the Commission on Social Welfare and in more recent times the Department of Social Welfare, as it was then, rejected the idea in a discussion document citing the following reasons:

- It would be difficult to reconcile an extra tax on profits with the commitment to maintaining a low rate of Corporation Tax
- Company profits would be a less predictable, more volatile, base.
- There would be a considerable redistribution of PRSI liability with a greatly increased burden on highly capitalised firms such as foreign owned multinationals in the information technology, pharmaceuticals and financial services sectors.

But are these concerns justifiable? The change would be tax neutral with the burden on business remaining unchanged and the redistribution of that burden towards capital intensive enterprises can be seen as favourable and unlikely to drive investment away given the current low rates of employers' PRSI in Ireland.

In a paper prepared for the INOU in 1996[4] on Company Taxation I estimated that a tax of 11% on profits before capital allowances would be needed to replace employers' PRSI. Corporate profits have risen significantly since so the required rate would now be somewhat lower.

[4] Company Taxes and Employment, Can the system be altered to encourage employment creation, Colm Rapple, November 1996.

Given the business opposition to such a change and the lack of any political or administrative desire for change this type of major reform is unlikely but changes in the low income exemption limits and the abolition of the ceiling of employee contributions are long overdue and shouldn't have to wait for a cut an offsetting cut in the top rate of income tax.

Table 1
INCOME TAX AND CORPORATION TAX
Cost of allowances and reliefs 2000/2001[1]

TAX RELIEF	€million
Relief in respect of medical insurance premiums	192[2]
Health expenses relief	41
Contributions under permanent health benefit schemes	4
Employees' contributions to approved superannuation schemes	472*+
Employers' contributions to approved superannuation schemes	646 *+
Exemption of net income of approved superannuation funds	1,292*+
Retirement annuity premiums (self-employed)	205
Interest on loans relating to principal private residence	211[2]
Rent paid in private tenancies	19
Exemption of certain earnings of writers, composers and artists	37
Exemption of interest on PO saving schemes	124
Special Savings Incentive Accounts	433[3]
Exemption of income of charities, colleges, hospitals, schools, friendly societies, etc.	34.3
Tax exemption on Child Benefit	315*[2]
Relief under profit sharing schemes	31*
Exemption under approved share option schemes	8*

Investment in Corporate Trades (BES)	17
Investment in seed capital	1
Relief for expenditure on significant buildings and gardens	3
Donation of heritage items	3

INCOME TAX AND/OR CORPORATION TAX

Capital Allowances including urban and rural renewal schemes	1,720
Rented residential accommodation	28*
Effective rate of 10 per cent for Manufacturing and Certain Other Activities	2,330
Double taxation Relief	308
Investment in Films	29*
Group relief	337

NOTES ON TABLE

*Figures accompanied by an asterisk * are particularly tentative and subject to a considerable margin of error.*

(1) 2003 figure

(2) 2002 figure

More detailed notes are available in the Revenue Commissioners annual statistical report the 2003 edition of which should be available in October 2004.

Table 2
Social security contributions 2000

	% of GDP	% of total tax revenue
Czech Republic	17.3	43.8
France	16.4	36.1
Netherlands	16.1	38.9
Sweden	15.0	28.1
Austria	14.9	34.2
Germany	14.8	39.0
Slovak Republic	14.7	41.2
Belgium	14.1	30.9
Spain	12.4	35.1
Switzerland	12.0	33.6
Finland	12.0	25.6
Italy	11.9	28.5
Hungary	11.5	29.3
Greece	11.4	30.1
Luxembourg	10.7	25.6
Poland	10.0	29.4
Japan	9.9	36.5
Norway	9.0	22.5
Portugal	8.8	25.7
United States	6.9	23.3
United Kingdom	6.1	16.4
Turkey	5.6	16.9
Canada	5.1	14.3
Korea	4.4	16.7
IRELAND	**4.2**	**13.6**
Mexico	3.0	16.4
Iceland	2.9	7.8
Denmark	2.2	4.6

Source: OECD Revenue Statistics

2.4

Land Values as a Source of Local Government Finance

(Capturing windfall gains from planning and using site value taxation to fund local government in Ireland.)

Tom Dunne

Introduction

Funding local government has been a permanent feature of debates about public policy in Ireland for so long now it is probably part of what we are. Many feel that the balance of power between local and central government is weighted too much in favour of the latter in Ireland. If this is to change then along with power at local level must go the responsibility to tax.

Looking at other developed countries we see many different arrangements for distributing power between local and central government. One thing all will have in common, however, is a land or property tax as part of the funding of local government. Ireland seems exceptional in not using them more than we do.

This was not always the case. In the past local authorities in Ireland were able to raise taxes to pay for local services through the rates system. Prior to their removal in the late 1970s rates on residential property were contentions. Despite this there is a view that their removal has contributed to the decline of responsible local government. Undoubtedly the lack of a substantial local tax is a crucial weakness of local government. But it seems that property taxes have become very unpopular. On the other hand rates on commercial property continue to exist even though they frequently arouse the ire of the business community.

Taxing windfall gains from planning decisions is also a perennial issue. Soon after the introduction of the 1963 Planning Act the phenomenon of windfall gains from planning decisions emerged. This prompted calls for reforms to capture these gains for the public good. Since then the issue surfaces regularly and the issue is examined again. The most recent of these is the Ninth Report of the All Party Oireachtas Committee on the Constitution (APOCC) which was well received and called for a Kenny type solution, referring to an earlier report on the matter [1].

All the while local authorities in Ireland remain short of funds to provide local services and produce the infrastructure that creates the public wealth so visible in the towns and cities of other developed countries.

From debates about these and other related issues it seems that any form of taxation of landed property would be contentious and unpopular. Nevertheless the case for both local property taxes and capturing the value created by planning decisions (this can be called value capture for convenience) is persuasive. Indeed, for many who examine the role that taxes on property can play in local government and funding infrastructure, the case for them can be compelling. This paper is intended to explain why.

At heart the issue is of course political. Before there can be a political will to introduce local property taxes and capture the value created by planning decisions the electorate would have to understand the rationale underpinning these. Only then might people come to a accept that property taxes and planning levies/charges are not an attack on private property rights, do not put up the price of property, do not make it more difficult to achieve home ownership, do not add further costs to businesses and industries and are not mad left-wing nostrums that should go the way of the Iron Curtain. This paper argues that on the contrary they do have a place in an entrepreneurial society with a free market orientation.

1. Committee on the Price of Building Land Stationary Office Dublin 1973

This paper suggests that the concept of economic rent, on which the justification for property taxes rests and its relevance to the property market in a modern, economically successful and urbanised Ireland, needs to be vented, discussed and debated. The proposition is that if a greater understanding was created about the economic characteristics of landed property both value capture and local property taxes would achieve greater public acceptance. They then could be used to facilitate more accountable and responsive local government.

The paper is organised into three parts:

Part one is a discussion about the specialist field of land and property economics. Noting that land and property have special characteristics, the paper suggests that the economics of property markets are not well understood in Ireland. It is suggested that this a result of our history. In Ireland they have not been a significant part of economic thinking perhaps because the data is not available to allow sufficient interest in research into property markets to take place in the schools or departments of economics at third level.

The section suggests that where information and market knowledge is deficient government intervention will always be troublesome and can have unintended effects. It is further suggested that the view that government should not interfere and should not apply taxes to property has credence because of past experiences with government interventions.

Recent contributions to debates about government intervention in the property market are also discussed with a view to exploring popular understandings of the operation of that market. In particular the validity of the view that house prices will be increased by measures taken to capture the value added to development land by planning decisions is discussed.

The second part looks back to the classical economists for insights into the distribution of the proceeds of high development land prices and considers what is called the Ricardian Residual Land Value Theory.

Using the concept of economic rent it argues that development land values are a residual and as such can be taxed without distorting production decisions. This part considers the usefulness of this theory as a means of analysing property and land markets and concludes that if it was accepted widely it would facilitate the introduction of measures to capture windfall profits from planning decisions and local property taxes.

The third part looks at local property taxes and the inadequacies of the rates system that applied here in the past with a view to learning about the characteristics of a more acceptable approach if land and site values were seen as an economic rent. It suggests that land or site value taxation might offer a suitable base for local property taxation.

Part 1:
Economics , Land and Property

Economics is the study of the production, distribution and consumption of wealth in human society [2]. The great Victorian economist, Alfred Marshall, had a more pithy definition that captures the essence of economics. He said that "it was the study of mankind in the ordinary business of life".[3] In English speaking countries the word economics has become more used than its precursor, political economics, with the intention that this would reflect what was seen as a more scientific approach to the subject than the value judgements implied by the former name. Over time it appears that mainstream economics has become more mathematical in an attempt to become more scientific. Perhaps something has been lost in this. The power of some of the concepts and ideas that formed economics and explain our world may have been lost to the rest of us non-economists.

2. Bannock,G, Baxter., R.E., & Davis,E. 2003 The Penguin Dictionary of Economics 7th Ed. Penguin Books.
3. Marshall, A. 1890. Principles of Economics 8th Edn London :Macmillan.

Funding local government, land use planning and building homes are all certainly part of the ordinary business of life. The power of ideas from economics in shaping our world cannot be doubted and the insights of economics can be meaningful in addressing the question of the influence of high development land prices on the price of houses.

The legendary Harvard Economist, John Kenneth Galbraith, called neo-classical economics a system of belief. If at least one of the concepts of the classical economists, Ricardo's "economic rent", was widely understood, popularly accepted and believed in, it would be of great assistance in debating issues such as local property taxation, supplying needed urban infrastructure and providing affordable housing.

The efficient operation of the price mechanism in the market place is a fundamental concept in economics and underpins the view that markets should be left to operate freely. Of the inputs or resources needed for production and distribution, land is much different to the others, usually referred to as labour, capital and enterprise. Most textbooks on economics acknowledge this and note that it is so because the supply of land is more or less fixed. In these textbooks landed property is widely regarded as a special case and it is recognised that the price mechanism alone can be inefficient in allocating landed property resources, including housing. This is usually given as the justification for government intervention in the free market by a variety of measures of public policy including the planning system.

In textbooks dealing with land and property economics a number of reasons are given for treating the subject as a specialist study. These are worth stating briefly and Harvey (1981) set them out as follows. First, physical defects and incomplete knowledge may reduce competition. Second, competition may not be perfect. Third, factors of production are often unable to move smoothly in response to price changes. Fourth, in addition to private benefits and costs upon which individual consumers and producers base their decisions there may be external benefits and costs; i.e. externalities are a big issue. Finally, it may be necessary or desirable for certain goods or services, (usually termed 'collective', 'public', and 'merit' goods) to be provided by the government[4]. These are typical of the reasons given for treating landed property as a special case. It follows that the economics of property markets require special insights often unfamiliar to those with a more conventional training or knowledge of economics.

The challenges of sustainable property development and the shortage and high price of housing, despite high employment levels and incomes at unprecedented levels, are not primarily planning questions or political issues, they are economic problems. The specific characteristics mentioned above, however, require tailored responses. Most ardent proponents of free market economics, therefore, do not see the price mechanism and the operation of free markets as being capable of solving problems in property markets. This has resulted in the acceptance of a wide range of government interventions in property markets. These extend from tax incentives such as Section 23 type mechanisms, much favoured by entrepreneurs and investors, through direct provision of homes to the needy and on to the extensive legislation surrounding land use planning. The latter of course provides for the involvement of community interests in land use decisions and gives them an influence over market operations.

Most economists readily accept specific interventions in property markets, particularly the planning system, even those of an extreme right wing hue. The details of the measures chosen or the bureaucratic procedures involved are often subject to criticism but the principle of the need for intervention is implicitly accepted. Indeed government intervention in property markets is so pervasive it is not seen by many calling on government not to interfere in the market in an attempt to resolve particular difficulties that emerge from time to time. The fact is that property markets are highly regulated and much influenced by government policy.

4. Harvey, J, 1981 The Economics of Real Property Macmillan, London.

To be effective, however, intervention needs intelligence and skill. This requires good and timely information about the market, properly collected and based on reliable statistics. There also needs to be specialist knowledge of how the property market works. This is not easy to achieve in Ireland at present given the lack of basic data gathered about property transactions.

If one compares the quality and level of information gathered for labour or capital markets, or indeed for the agricultural industry, to that gathered by government about property markets one will immediately see that any government attempting to influence the property market is doing so almost blindly. Often it is said that using economic statistics to guide future policy is like driving a car forward using only the rear-view mirror. In the case of property markets the mirror is very small and very dim.

As a result measures introduced by the government from time to time, often through the planning system which is not led by economic considerations, frequently have unintended consequences and create problems elsewhere. Not surprisingly this convinces many that the government should not interfere in property markets. Misplaced intervention, therefore, serves to justify the case for no intervention in the mind of many with right wing perspective. It could be said that this fuels a prejudice and that an objective response would be to argue for more intelligent intervention based on reliable market information.

As an aside it is worth mentioning that an important unintended effect of local property taxes could be greater intelligence about property markets. This would certainly help economic policy and planning.

Up to recently property and housing economics were Cinderella subjects for economists perhaps because of the absence of basic raw data. Since the advent of the Celtic Tiger, however, many economists have turned their attention to the property market, led perhaps by those employed in the larger firms of estate agents. Others in financial institutions and stockbrokers have also taken a keen interest as residential mortgages and property investment became very profitable enterprises for them. Mostly they rely on the limited information published by the government but they also have considerable in-house information available to them because of their business operations. Also using data that are available some academic economists have recently taken an interest and analysed the house market with a view to considering whether the conditions were characteristic of a speculative boom.

Conclusions reached from these sources must remain tentative, however, not least because of the limited data on which they are based. The overall picture is of a sector that is not well understood or researched compared to other sectors of the economy. This is largely because the raw material for this, statistics about transactions in the market are not gathered to the extent needed.

It is interesting to note that before reacting to the boom in house prices the government in the late 1990s sought and commissioned an extensive study of the residential property market and only introduced major changes in policy on foot of its recommendations. This was a hopeful departure from the traditional approach to dealing with housing issues. It could be said that prior to the Bacon Reports[5] governments reacted to crises in housing and property markets almost on the hoof. Often it can be said the incumbent minister of finance or the environment based decisions on their instinctive understanding of what would be an appropriate response to market difficulties. In the past these took the form of increased grants and incentives for first time buyers and other measures designed to support the construction industry. Often these were done on the premise that this would also have the beneficial effect of moping up surplus labour in times of economic difficulty and they may have had unintended effects that adversely affected national welfare. Not only do governments generally not research property markets, they rarely evaluate or quantify the costs and effects of tax breaks and subsidies given to participants in property markets. The Bacon Reports were a welcome change.

5 Bacon and Associates 1998, An Economic Assessment of Recovery House Price Development, Dublin, Stationery Office

By any standards the Bacon Reports were good pieces of analysis and they provided very useful insights into how Ireland's booming housing market worked at the time they were published. Unfortunately however, the measures introduced by government on foot of these reports are now mostly seen negatively. In particular the removal of interest relief from investors and increasing stamp duties substantially were not well received and were seen as damaging the market without solving the essential problem of high prices and shortages. This proposition has not been researched definitively and if it was a different picture just might emerge. Nevertheless, it appears now that the argument not to interfere in the property market further has gained weight.

This view may also result from the introduction of important new policies by way of the major revision of planning legislation implemented by the 2000 Planning Act. Two of these, commonly referred to as Part V and the Development Levies, have been the subject of much discussion and remain contentious. Comments reported in the media about these are worth discussing in more detail as they illuminate understandings of land, property and housing economics currently prevailing among those involved in property development and the media.

The Irish House Builders Association (IHBA) has been a prominent contributor to debates on these issues in the national media. They have often suggested that these measures will push up housing costs. In considering the question of popular understanding of economic theories pertaining to land value and house prices it is useful to go into more detail about these contributions. The following will give a flavour of the tone of them and the understanding abroad about of relationship between house prices and the price of development land.

In a newspaper article Hubert Fitzptrick a Director of the IHBA wrote "that a new homebuyer not qualifying for affordable / social housing now bears:

- Additional site costs for complying with 20% social and affordable housing.

- Additional development levies subsidising social and affordable housing”.

He also pointed out that the *charges levied under these schemes will have a severe impact on the price of new houses* and encouraged buyers to raise these issues with their local politicians to reject what he called these stealth taxes [6]. (Emphasis added)

Prior to this the IHBA had taken out a large ad in the Irish Times saying “don’t let your local Councillor put thousands of Euro on the cost of your new home[(5)].

What is interesting about these and many other contributions to the debates on house and land prices is that they rest on what appears to be an *a priori* assumption that high land prices are a cause of high house prices and that anything that adds costs to developers by way of levies or additional responsibilities will increase house prices. Indeed, from press cuttings I have kept over the past couple of years it appears the view that high land prices are driving high house prices is the prevailing wisdom in our society and certainly in much of the media.

This needs to be challenged and explored. The proposition that measures such as Part V or Development Levies add to the price of houses for first time buyers may just be a self serving argument put forward by those who have a vested interest in maintaining that view as a general understanding in society.

It is instructive to go back to classical economics to consider the issue. At this point, however, we may conclude that land, property and housing economics are a special case and require specific understandings of the application of economic theory. These may not be prevalent in our society even among many involved in the property and construction industries.

6. Irish Independent 5th Nov 2003.

This should not be surprising given the history of our state. The recent report from the All Party Oireachtas Committee on the Constitution (APOCC) suggested that "because of the rural ethos of the Republic of Ireland state in the popular and dominant narratives of Irish history urban life and urban culture played only a modest part". Indeed the committee noted that Land Value as a rule is neither prominent nor discussed fully in standard modern textbooks[7].

It may be that as a society we have some way to go before the particular nature of property, land and housing economics are understood in a way that allows politicians to introduce measures that use value capture and local property taxation to fund local government. As a contribution to this it is important to begin with an understanding of the concept of economic rent. This will take us to David Ricardo, a name familiar to most who have studied economics and then onto what will be termed the Ricardian Residual Land Value Theory.

Part 2
The Ricardian Residual Land Value Theory

David Ricardo (1772-1823) a sometime parliamentarian, who, incidentally, was an MP for a constituency in Ireland, made a vast fortune from the stock market, retired at 42 and took to studying and writing about economics. He was equally successful in this endeavour and his book *The Principles of Political Economy and Taxation* (1817) dominated economics in England for a large part of the 19th century.

A major concern of his was the Corn Laws. These were intended to prohibit the importation of grain to the UK until the price of domestic grain increased a specific amount. Prior to 1817 landowners had increased the acreage given to grain cultivation when produce from the continent was cut off by war. They now wished to avoid financial

6. Irish Times 26th Nov 2003.

hardship as war ended and imports resumed. But industrialists were concerned that the high food prices would lead to higher than necessary wages for workers. They believed that the Corn Laws were in fact a special treatment for a favoured few (the landowners) at their expense.

As landowners controlled parliament the Corn Laws passed but subsequent debate did much to define economic interest groups. Ricardo attacked the Corn Laws and in the course of many contributions to economic debates said that “the price of corn is not high because a rent is paid but a rent was paid because the price of corn is high and it has justly been observed that no reduction would take place in the price of corn although landlords should forgo the whole of their rent”. Ricardo defined rent as “that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil” [8] By the way we might not be surprised to learn that Ricardo felt that the interest of the landowner “is always opposed to the interests of every other class in the community.”[9]

Ricardo observed that alone among the factors of production land is inherently scarce. Landowners will therefore more often get an extra payment over and above the normal return due to them from their asset in times of scarcity or when laws contrive to keep prices of a product above that which would prevail in their absence. This extra payment the owner gets over and above the next best use of the factor is called an Economic Rent. The meaning of the term ‘economic rent’ is not an easy one to grasp and probably does not adequately convey what is meant by the concept. A new more evocative phrase is needed.

8. The All Party Oireachtas Committee on the Constitution, 2004 Ninth Report Private Property, , Stationary Office Government of Ireland.
9. Ricardo D 1911 p33 The Principles of Political Economy and Taxation J.M.Dent & Sons Ltd London (First Edn. 1817).

Nevertheless Ricardo's thinking proved attractive to many discussing and debating economics in the 19th century. Prominent among them was Henry George who wrote a very widely read book *Progress and Poverty* (1879)[10].

George was struck by the observation that during the 19th century the industrial revolution brought great progress and great wealth to industrialising countries but with the wealth came with extreme poverty. He concluded that " the association of poverty with progress [is] the great enigma of the day". As a solution he proposed a "Single Tax" that would confiscate the Economic Rent from land and remove all other forms of taxation.

The ideas of Henry George were widely discussed and debated in the late 19th century and influenced political thinking to a remarkable extent. This had considerable effects and prompted Liberal Governments of the early 1900s to introduce what would now be seen as very radical measures concerning land and property taxation. Unfortunately with the fall of that party and the rise of the Labour Party in the UK during the 20th century most of these were repealed and over the course of that century the emphasis moved to socialist solutions to land issues based on administrative formulae. These were mostly removed by succeeding Conservative governments.

Nonetheless today the ideas put forward by Henry George still inspire many examining issues around planning, urban development and methods of funding infrastructure. Indeed there has been a revival of interest in him in the UK and the US in recent years as those looking for more equitable means of distributing wealth that exists in nature have extended the concepts used to justify taxing land to apply to other natural resources.

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10. Canterbury, E. Ray, 2001. A Brief History of Economics World Scientific Publishing Co. Pte Singapore p87.

By the way lest anyone think that George was in favour of full blooded socialism it is worth pointing out that he preferred the use of market mechanisms such as taxation rather than government control. Incidentally when he came to Europe he was first employed as an American correspondent for a publication called the Irish World and immersed himself in Irish Politics.

In modern times Economic Rent is defined as the difference between the return made by a factor of production and the return necessary to keep the factor in its current occupation. In the nirvana of liberal economics, perfect competition, no such rents are made by any factor of production because changes in supply bid prices of inputs and labour down to the level just necessary to keep them employed. In economics true economic rents are recognised to be among the few returns that can be taxed without distorting production decisions which was the aspect that Henry George built on in making his proposals.[11]

It is the latter quality that should be of particular interest to us. In seeking alternative approaches to dealing with high land and house prices, the need to fund infrastructure and finding sources of finance for local government, surely this is vitally important. The usefulness of this concept and the help it can provide to finding solutions to these problems seems to me, however, to be overlooked in Ireland.

Perhaps this is because as noted already it is a difficult concept to grasp and is not intuitively understood even by many who study economics. Perhaps also, it was inevitable that this might be so given the history of the state. In his new book *Preventing the Future* Tom Garvin argues that "culture and mentalité, combined with Joe Lee's 'possessor principle' or rent seeking by a half peasant political community to hold the country back for a generation"[12]. Rent-seeking is behaviour that improves the welfare of someone at the expense of the welfare of

11. George Henry, 1879 Progress and Poverty, Centenary Edn 1979 Condensed, Henry George Foundation The Hogarth Press London
12. Garvin ,T., 2004 Preventing the Future, Gill and Macmillan, Dublin

someone else. Lobbying for laws that ensure landowners are entitled to increases in value due to planning decisions can be seen as this kind of behaviour**.** At the very least possibilities of capturing economic rents for the community is unlikely to be encouraged by those benefiting from them, particularly if they can influence politics by forming powerful lobbies with representation in important policy making forums.

Yet is seems also true that Ricardo's thinking on this has not been prominent in other countries, including the UK. This is worth exploring somewhat. Perhaps one of the reasons why is that Ricardo had asserted that the proportion of total income that goes towards rent payments will increase with economic growth. It seems that this did not happen.

The predictions of classical economics such as Ricardo have been evaluated with respect to agricultural rents and studies of the issue concluded that in the US at least, rents were trifling as a fraction of national income as early the 1800s. It has also been suggested that land value as a faction of aggregate wealth would continue to fall mostly due to shifts from land intensive sectors to other sectors of the economy. In contrast to the situation that existed in the 19th century in a modern economy technology and capital investment are now much more important in the production of goods and services than land. Baker and Sa-Aadu(2004) have noted, however, that there is some evidence that land rents have increased as a share of national income during the 1990s in the US.[13] It seems to me entirely likely that this is the case in the Ireland of the Celtic Tiger.

It may be that if a principle is established as pointing to some reality but the consequences forecast do not come to pass the conclusion might be drawn that the principle may not be valid. This ignores the fact that circumstances change and the consequences may not have

13. Baker ,D & Sa-Aadu, J 2004 Is real Estate Becoming Important again A Neo-Ricardian Model of Land Rent Real Estate Economics Vol 32 1 pp 33-53

come about for other reasons. Ricardo and George may simply not have been able to see the rise of the productive capacity of capital and technology relative to that of landed resources and that the importance of the contribution of landed resources to wealth holding, declined as a result. This does not mean that the analysis is wrong.

Nevertheless the basic foundations of Ricardo's theory have been the subject of considerable criticism. Verhage (2002) has pointed out that the residual theory can be seen as a behavioural approach used by practitioners to determine the price of housing and more sophisticated tools have been sought to analyse land and house prices. That practitioners use this theory is not in doubt, as we will see later. Criticisms such as these have resulted in what is called the neo classical theory of land prices that uses two central notions: transfer earnings and economic rent. Not surprisingly given that this is a debate among academic economists, this is a theory that has been criticised too.[14]

Notwithstanding this when considering problems in land and property markets the concept of economic rent remains a useful conceptual tool. The more modern form of this line of thinking, what can be called the Ricardian Residual Land Value Theory suggests that land prices are a residual left over after costs and profits have been deducted from the price of a property.

To put this simply in the case of housing, high prices cause high land prices. It follows that if somehow the government were able to fix the price of development land at a fraction of what it is now, through say administrative measures such as price control, the price of houses would not fall as a result.

14. Verhage, R. 2002 Local Policy for Housing Development European Experiences. Ashgate Publishing Ltd Hampshire England

Ball (1983, 1996b) pointed out "that house and land prices are simultaneously determined with the direction of causality flowing from house prices to land prices rather than vice versa". He states that "…. Residential land prices,… depend on the profitability of residential development. When profits rise, residential developers bid up the price of land and vice versa, so land prices do not cause high house prices but are a residual consequence of the level of house prices relative to construction costs"[15].

It is worth noting that as suggested by Verhage the residual theory is a behavioural approach used by developers to determine the price of land prior to investment in the infrastructure that makes it capable of development. Perhaps not surprisingly, therefore, it is the foundation of the perspective that property professionals have about the issue of the high price of development land and has been used by their professional bodies in this state when making considered submissions to government commissions and inquiries into this problem[16]. These submissions mirror those made by the Royal Institution of Chartered Surveyors to inquiries into land issues in the UK

The use of this theory in practice can be readily appreciated if one looks at the textbooks used to educate property valuers, real estate professionals and chartered valuation surveyors. One of the standard methods of property valuation presented in those texts is called the residual method of valuation or the developers equation. This proposes that the amount that a developer can pay for a development site or land can be assessed in the following manner.

15. Ball M 1983 Housing and Economic Power: The Political Economy of Owner Occupation Metheun, London, and see also Ball, M. 1996b Housing and Construction : A Troubled Relationship, the Policy Press and Joseph Rowntree Foundation Bristol and York.

16 See submissions by the Society of Chartered Surveyors(SCS) and the Irish Auctioneers and Valuers Institute (IAVI) to the APOCC and previous submissions to the Joint Oireachtas Committee on Building Land and to the Committee on the Price of building Land (1972) [the Kenny Report].

Start by identifying the most appropriate development for the land/site and then appraise the current market value of this. This is usually referred to as the gross development value (GDV).

Next estimate the costs of development and construction using current rates. The next stage is to deduct this from the GDV leaving a residual figure from which financing and acquisition costs can be deducted to arrive at the price to be paid. Ricardo would readily recognise this method.

A further example of the residual theory in operation in contemporary property/real estate markets is the modern commercial lease. Known as the 35x5 Full Repairing and Insuring Lease (FRI), this is an institutional arrangement familiar to all who work in real estate and illustrates the point made by Ricardo in that it tries to derive the pure rent paid by the tenant for the property asset provided by the landlord. In this case, however, the economic rent paid for the land is somewhat obscured by the fact that the rental payment is for the land and buildings bundled together.

For valuation surveyors who have experience of the property market and the way it works, and have used the residual method of valuation in practice, the witticism "it works in practice but the real question is does it work in theory?" has an uncanny resonance when one reads Ricardo.

What can be concluded from this discussion? Certainly it can be said that as a means of analysing property and land markets the Ricardian Residual Land Value Theory has a lot to offer. Once grasped it allows a different view of the make up of house prices to that which seems to prevail in our society. No more than the price of corn in the early 19th century needed to be kept high so that rents could be paid, the price of property is not high because of high land prices. The land element is a residual and high development land prices are a result of high property prices not a cause. Development land prices should be seen as an economic rent and could be taxed without affecting production or

consumption decisions. Builders farmers, land speculators and developers are essentially in the same position as those landowners who argued for the Corn Laws. It appears that some things endure through history despite modernity!
If the public were to accept this analysis then the value created by planning decisions, and in particular the vast increases in the value of development land arising on foot of rezoning decisions, could be returned to the community that created them in the first place. Crucially this would be seen to be done without increasing the price of accommodation.

Moreover, if the public accepted that the price of development land largely represents an economic rent then the debate about high land values would change fundamentally. Arguments put by those with vested interests in maintaining existing arrangements under the planning acts, whereby the value created by planning decisions is kept by the landowner, might be seen as self serving justifications for rent seeking. Certainly they would be challenged more than they are now.

We in Ireland need to re-conceptualise development land and the profits that can be had from dealing in it. In particular if we could see development land not only as the bounty of nature but also a product of man, a major shift in the distribution of resources could be achieved. This shift would see development land as product made up from the original agricultural land provided by nature to which is added community capital and the labour and enterprise of local authorities to provide serviced sites on which buildings could be put. The reward or profit for this production should go to the local authority and not be gifted by way of a rezoning decision or planning permission to the owner of the original land. What they are entitled to as of right is the value of their land as agricultural land.

Part 3: The Theory and Local Property Taxes

Using local property taxes to fund local government is common in many developed states and could be accepted here if people see that the value of land is an economic rent. At present it appears that people understand only very poorly the way local authorities are funded in Ireland. Of course there is the appreciation that their finances come from a variety of sources including service charges, bin taxes and rates. It is also understood that a substantial chunk is given to them by central government. The amounts and proportions involved are, however, not familiar to electorates who also have a ready appreciation that the waste and water charges seem arbitrary and are not closely related to consumption.

Furthermore, the basis for deciding how much each local authority should get from central government is not widely known. The composition of the Local Government Fund (LGF), introduced in 1998 and comprising the proceeds of motor taxation and an exchequer contribution, is not widely understood. Moreover, the Needs and Resources Model developed by the Department of the Environment and Local Government seems specially esoteric and not particularly suited to circumstances of individual local authorities. For instance, this has been criticised on the basis that the specific needs of the role of Dublin City as a capital are not recognised in the distribution[17].

Local government is responsible for the provision of a wide range of services and infrastructure that support individual properties which clearly would not be as valuable without them. On the face of it, therefore, it appears logical to base a tax to fund local authorities on the relative values of the properties benefiting from local infrastructure and services.

17. Lord Mayor's Commission 2002 Dublin City Council

Certainly when a property is acquired it comes attached to the services provided by the local authority. Individual properties also benefit directly from local roads, public lighting, parks and amenity land maintenance carried out by that authority. This is so obvious it is often hard to see. When buying property people are not generally conscious that they are also acquiring rights to infrastructure and services. Of course they are perceived to exist but access to them is seen as a right flowing from their existence as a citizen and their payment of general taxes.

But is this the case? Let us think about this. When a house is bought in, say Dublin, it comes with a virtually unlimited water supply. In other countries water services have to be paid for and in some, France and England for example, the companies supplying water are private and charge for their product. Clearly if this were charged for in, say, Dublin the price of a house would be reduced to reflect the changed circumstances. Instead of paying an upfront capital sum included in the price of the property and passed to the vendor as capital, an annual payment would be paid to the water authority. This should provide the income stream to secure operational maintenance and future investment. If the charge was metered it would also effect some economy of use.

Water is but one of the services supplied by a local authority, which directly benefit property holders. Others that come to mind immediately are the maintenance of access roads, public lighting, parks and sewage removal. These are what are called in economics merit or collective goods and it is recognised that markets are not good at supplying them. These need to be funded in addition to funding responsibilities for the provision of social housing and local administration and other services.

Here in Ireland in the nineteenth century many of these services were provided by local government and were funded by a local tax. This was based on the value of the properties located in the functional area of the local authority. Indeed in Dublin at least people also paid separately for their water. This system was popularly known as “the rates”. Even before then various means of exacting taxes from property holders were devised using much less sophisticated methods. Examples are window and hearth taxes. Presumably the thinking was that such taxes were a proxy for the value of the property and this is turn would be related to the means of the occupier.

The rates system is therefore based on the proposition that people should be liable for the communal responsibilities in the area in which they live in proportion to their ability to pay, it being assumed that the more valuable the property occupied the greater the means.

Putting is at its simplest the local authority simply added up its expenditure and divided the total by the total of the rateable valuations in its functional area. This gave a rate in the £, which was then applied to the rateable value (RV) of each property. The RV was very simply the annual letting value. Introduced around 1850 and preceded by a less sophisticated poor law system with roots as far back as 1600, rates were paid to local authorities in respect of all property, including agricultural land it must be pointed out, right up until the latter part of the last century.

The Rates system was very simple, readily understandable and particularly suited to the stable monetary conditions that applied from the 1850s up until the early part of the last century. It was also very transparent in an era when most people rented property and knew the relative annual values of their holdings. The RVs were established throughout the country by what became known as Griffith’s Valuation after the first Commissioner of Valuation, Richard Griffith and completed during the 1850s. This was never revised and as late as the 1970s RVs were still related to the original assessments made by Griffith.

The rates system had fallen out of favour and was allowed to decline during the 20th century. It is, therefore, worth looking at the history of the rates system to illuminate some of the considerations involved in levying a local property tax.

Rates became unpopular partly because valuations were not kept up to date. Also there was a change during the 20th century to mass owner-occupation, which obscured the valuation base somewhat as it relied on annual rents for unfurnished property a largely unknown amount in an era of rent restriction and rent control. The latter are nice examples of government interventions in the property market having an unintended effect of rendering the rates system more obscure that it was before.

For more than a century after Griffith’s Valuation, valuers in the state Valuation Office carried out the assessment for RVs and very few people understood the system. To most the assessment of RVs were as obscure as Harry Potter’s adversary, Lord Voldermort’s, magical formulae.

In many ways the assessment of RVs for commercial property today is still an arcane science known only to a privileged cognoscenti. This will be improved when the measures provided for in the 2000 Valuation Act are brought fully into force. Nevertheless even with this it seems unlikely it will be any easier to relate the contribution made by businesses to the services provided by local authorities in a meaningful way. This is partly due to the lack of clarity about the role rates pay in the current system of local government finance.

It should not, therefore, come as a surprise to learn that IBEC and the Dublin Chamber of Commerce have recently criticised recent rates increases. They point out that even though there have been substantial increases in other local authority charges the rates bill still goes up. This leads to suspicions that the system is being used as a general tax rather than a payment to fund the services of local authorities that benefit business premises. It seems likely that the business community will react even more strongly if there are rates increases in the future and that the rates system will become increasingly unpopular as well as being poorly understood. Certainly some confusion is abroad about the role rates play in funding local authorities.

From the points made by employers and business organisations it appears that their view of the effect of rates is to increase business costs. The Ricardian view would hold that the rates burden would be passed on to the landowner in the form of lower rents. As this view does not prevail, rates remain deeply unpopular and lack public acceptance. This continues to militate against their survival

The rates system had, justifiably, been unpopular for many years prior to its removal from domestic property. Generally it was subject to three criticisms which became more widespread as the burden increased. These were noted in the Final Report of the Commission on Taxation[18] which reported in the mid 1980s. These are worth stating.

Firstly, as noted above the valuations used had not been revised virtually anywhere since the system was introduced in the mid 1800s. Essentially the valuations used right up to the 1970s were based on the annual letting values of residential property in the 1850s and were often around €20-50. Rateable valuations at this level were meaningless to the average householder rendering the system discreditable.

Second, the liability for rates was not related to ability to pay. Local property taxes tend to be regressive and inequitable not least because as was widely recognised by urban economists at the time, poor people tend to spend a higher percentage of their income on housing. This was indicated in practice in Ireland by experience with the Residential Property Tax (RPT) where in 1991 of 16,145 householders over the valuation threshold some 6,205 (38%) did not pay tax because of the income limit and is indicated by T. Callan of the ESRI in 1991.[19]

This situation has probably got a good deal worse since 1991 with the spectacular increases in property values in Ireland in recent years. It is now likely that a lot of people are living in houses worth many multiples of their income even if this was quite high. Property price increases have more than likely removed the tentative connection between income levels and the value of the property occupied by the vast majority of owner-occupiers.

18. Final report Commission on Taxation 1985 Government Publications Dublin
19 Callan T 1991 ESRI

RPT was an annual tax charged at 1.5 per cent per annum on the market value in excess of IR£65,000 of a property owned and occupied by a person if the household income exceeds IR£20,000 and both thresholds were indexed. This was a highly unpopular measure and was removed just before the current residential property boom took off.

The fact is that as people get richer the proportion the value of their domestic property bears to their income can decrease. Also and of growing importance in recent years with the rapid property price increases one can get what is referred to in the UK as the “Devon Pensioner”. This is an older person living in a valuable house on a smallish pension who could not afford to pay a tax based on the value of their accommodation.

It may be concluded that the correspondence of income to the value of the property occupied no longer holds good in a home owning democracy thus undermining one of the ancient foundations for the imposition of taxes based on the value of property.

Thirdly, the rates bill came in two parts one every six months requiring the ratepayer to find large cash sums often the equivalent of €600+ to day.

To these might be added three further important reasons.

Firstly, often the groups bearing the lowest or indeed no rates burden but with votes had an incentive to elect those promising to increase or improve services. Farmers or indeed householders who could vote for those advocating increased services which would not only put up their own rates bill but also increase the rates bill of businesses who may not have benefited from these. Businessmen paying rates on commercial property but not living in the local authority area have no vote but are taxed.

Second, and this may not be readily understood, rates operated as a tax on improvements to land. A ratepayers bill went up if physical improvements were carried out to the property or if it was extended. Clearly work of this nature would tend to increase the value of the property and as the rates system relied on relative valuations, improving a property increased the rates bill. This was hardly a satisfactory tax for a growing economy where property improvement was inevitable and desirable.

Thirdly, revaluations will always be necessary but will be contentious, as they will create winners and losers. Over time properties in some areas will increase in value faster than others and their owners will end up with an increased burden. Councillors calling for a revaluation are likely to be penalised by those who lost and may not be rewarded by those whose bills have gone down. This situation will arise in the UK in the near future when the Council Tax bands are revised. It is likely that the revaluation in the UK will be associated with increased demands for reform of the Council Tax system.

Of course these criticisms could have been overcome and the rates system continued. What little attempts were made to improve the system were made initially by removing certain classes of property usually those used for charitable or religious purposes. Later the liability for rates on agricultural land was reduced. (This was long before rates were removed for agricultural land completely in the 1980s) These made the system less fair. Incidentally what are called "Constituency Offices "were de rated following the Valuation Act 2001 in what could be seen as a nice bit of rent seeking on behalf of political parties.

Alternatively the government here could have put effort into devising an alternative system following the recommendation of the Commission on Taxation. Indeed the UK government under Margaret Thatcher put enormous effort into finding an alternative to rates during the 1980s ending up with the present Council Tax. She had a deep antipathy to the rates system, which as it had sprung from substantially the same roots as Ireland's, shared many features noted above. Her proposal, the so called Poll Tax, was instrumental in her downfall.

Eventually a Council Tax based on the value of property was introduced and remains to this day despite much criticism which is likely to grow as the date for the revision of the initial valuation assessments comes nearer.

Despite all the known disadvantages of the rates system the Commission on Taxation concluded that property taxation is the only practicable method of raising significant sums in local taxation. They also concluded that if it were decided to have a system of local government in Ireland such a tax should be devolved fully to local authorities.

With the removal of rates our system of local government finance relies very heavily on funds that come from central government. Any review of the existing system of funding local government would have to conclude that it is seriously deficient not least because it is not readily understandable by those who have to vote for councillors. Building on the existing rates system is not an option. Many of the criticisms laid against such a system and outlined above would still have validity.

In any event given the appalling way the rates system was allowed to decline and become so inequitable, it should come as no surprise that there is considerable antipathy to local property taxes in Ireland. No politician now would survive if they vigorously advocated local property taxes as it would be very hard to convince people that it was not proposed to bring back rates.

Perhaps a radically different approach might work. A system is known as site-value rating (SVR) or land–value taxation (LVT) might capture the imagination of people if they accepted the validity of the Ricardian Residual Land Value Theory. The theory points to taxing the land element of property value only. This would be a suitable form of local property tax and not be vulnerable to many of the flaws of the old rates system.

Briefly the mechanics of the system would be as follows. The land only element of the property would be assessed as the open market value of the site on the assumption that is currently available for its most profitable use in the context of the local development plan. The value of buildings or any improvements would be ignored but it would be assumed that all neighbouring properties were developed at the time of the assessment. Hence what is being taxed is not the buildings or the improvements but the land element alone. The system could also be applied to agricultural land. Effectively it attempts to capture the economic rent attributable to the land element of property. Property owners would be liable for a share of local government finance based on their site value assessments. A pilot study of site value rating has been carried out in Oxford in the UK.

Site Value Rating has the following advantages:

Firstly, the increase in the value of individual properties due to infrastructure and local service improvements would be captured in part at least by those responsible for them, the community / local authority.

Secondly, it would improve the efficiency of land use and provide a disincentive to hoarding land or holding land that is surplus to one's requirements. This would lead to a more efficient use of a valuable resource, the stock of property assets that exist at any given time.

Thirdly, in the long run SVR should provide a deterrent to using land extensively and encourage the increased density of development that is required to support public transport systems. This would reduce city sprawl and journey times to work.

Fourthly, and this is important, particularly in Dublin which has four competing local authorities, such a system would reduce the incentives for local authorities to zone land for commercial uses by way of competing for these with other local authorities.

Finally, more objective planning decisions would be encouraged as

SVR would mitigate against high development land values and remove the distorting effects of these.

There are some difficulties with implementing such a system, mainly concerned with the need for good basic information to allow the site/land valuations to be carried out efficiently and accurately. This would involve the creation of a cadastre or a map of property holdings. This requires the use of modern information technology which is readily available and in use in other countries. Incidentally such a system could have the benefit of making conveyencing much speedier and cheaper.

Public agreement to such a system would require an acceptance of the Ricardian principle that land values are a residual. Once it is appreciated that land unlike goods and services has no cost of production but acquires value only because of the competing needs of people in the community for space and accommodation this could be achieved.

Conclusion

Funding local government and infrastructure could be approached using measures that rely on the theory that property values are determined in a market by demand and not driven by the price of development land or sites.

The value of development sites or land can be seen as a residual or an economic rent and therefore available to be taxed to recoup the value created by the community by local authority services and infrastructure provision.

Taxes could take the form of development levies or charges or other measures intended to capture planning gain. These could be applied to providing the capital for infrastructure. Site or land value rating could be used to provide local authorities with an independent revenue stream based on the site values of properties in their functional areas and this could be applied to funding the annual cost of providing local services and maintaining the existing infrastructure.

Accountability could be achieved by the electorate perceiving that wasteful projects or programmes proposed by councillors would increase their taxes and they would only accept those where they see a real benefit. This would enhance local democracy

Finally, just as landowners argued in the early 18th century for the Corn Laws so those with a vested interest in land today will continue to argue that development charges and levies will increase the price of houses or local property taxes add costs to businesses. But these arguments should be more closely scrutinised. Maybe they will be seen as self-serving justifications for continued rent seeking. Hopefully they will be easily refuted by those with a real interest in a well planned and sustainable built environment.

3

Inclusion through the Tax System

3.1

Tradable Quotas - The Fairer Alternative to Eco-Taxation

Richard Douthwaite

The boundless frontier, with its promise of ever more oil and gas, more virgin forests, more fish in the sea, more fertile land, more places to dump our rubbish - those days have gone. Rather belatedly, humanity is having to learn how to live in a world with limits. The observance of some of these limits - like the total amount of carbon dioxide we release into the atmosphere - is of vital importance to the future of the planet while sticking to others, such as the number of polyethylene shopping bags used in supermarkets each year is merely desirable.

This paper argues that governments need to distinguish between critical and desirable limits and use different techniques to ensure they are observed. Specifically, critical limits need to be enforced using quotas while taxes can be used wherever more elastic limits apply. Let me explain the difference between the two techniques.

Under a quota system, someone, whether it be a local authority, a national government, the EU or some world body, decides the maximum rate at which a resource can be exploited without a critical threshold being reached. It then puts into place a system to allocate and enforce that quota so that the rate of exploitation stays below the threshold. Let me give an example.

The natural sinks which absorb, or break down and thus render harmless, the greenhouse gases we release into the atmosphere are the best current example of a resource which has been exploited beyond its ability to cope. As a result of our overloading these sinks, the concentrations of the various greenhouse gases in the atmosphere are rising. This is warming the Earth and carries the risk that at some point in the not-too-distant future, the world's climate could suddenly flip from the present stable regime to another stable, but quite different one. Ice core samples show that this has happened in the geological past in the space of about fifteen years.

The average global temperature has risen by at least 0.6 degrees Celsius since fossil fuels began to be used in quantity at the start of the Industrial Revolution and the rate of the rise is accelerating. Consequently, deciding where the critical threshold lies boils down to assessing how much more of a temperature increase we dare risk. Although the scientists attached to the UN's Intergovernmental Panel on Climate Change have not suggested a temperature-rise limit, several research institutes and NGOs have done so and have come up with broadly the same figure. The Climate Action Network's estimate[1] is typical. It is that if our goal is to prevent dangerous changes in the climate then "global mean warming needs to be limited to a peak increase of below 2°C (above pre-industrial times)."

Even this is very risky. "2ºC would be a death sentence for tens of thousands and perhaps millions of people, a commitment to catastrophic losses of species and ecosystems, and, frankly, an invitation to a sharp exacerbation of geopolitical and military instability" writes Tom Athanasiou of the US organisation, EcoEquity[2]. And that would be the best outcome. A two degree rise might well exceed the threshold, causing the world's forests to burn and touch off a runaway warming, or stopping the Gulf Stream plunging Europe into a new ice age. We don't know.

1 *"Preventing dangerous climate change"*, CAN position paper released at COP-8, New Delhi, India. Available at http://www.climatenetwork.org/docs/CAN-DP_Framework.pdf

2 Taken from the essay 'First the bad news' at http://www.ecoequity.org/ceo/ceo_7_2.htm

Once a temperature target has been chosen, the next step is to convert the "acceptable" temperature rise into the quantities of greenhouse gases that can be released without breaching it. There is no certain way of estimating these since we don't yet know enough about how sensitive the climate is to increases in the atmospheric concentrations of each gas. However, a guesstimate is better than having no figure, no order of magnitude at all, since if we start an emissions-reduction process we can speed it up later if we find the estimates were too generous and would take temperatures over the top.

Of the four main greenhouse gases – carbon dioxide, nitrous oxide, low-level ozone and methane – the first three are mainly the products of fossil fuel use, with CO2 contributing around two-thirds of the heating effect. Methane is rather more complex. Roughly 20% of its emissions[3] are the direct result of fossil fuel production, 30% are natural and the final 50% is due to other human activities, most of which fossil fuel use intensifies. So, all in all, if we control CO2 emissions, fossil fuel use will fall and the production of the three other gases will drop too. Consequently the quota we are seeking is the total tonnage of carbon dioxide that can be released into the atmosphere without exceeding the critical limit represented by the temperature target.

By the time humanity has used up this quota, it needs to have brought its emissions back down to the level at which the sinks can cope so that there is no further increase in atmospheric concentrations. The global community therefore needs to cut its emissions year by year at a rate determined by the quota until the balance between emissions and sink capacity is restored.

This distributes the use of the quota over time. The next step is to decide how each year's share of the overall quota should be distributed amongst those who need to use the sinks as a resource. In this case, as in some others where critical limits have to be observed - water supply

[3] http://cires.colorado.edu/people/tolbert.group/data/Chem5151/natlogar_files/frame.htm

and refuse disposal, for example - everyone either needs to use part of the quota themselves or can claim an equal right with everyone else to do so if they so choose. So how do we share each year's carbon dioxide tonnage out amongst the people of the world since it is, essentially, their fossil fuel ration? There are three basic ways. One is to have an international agency sell CO2 emissions permits representing each year's tonnage and use the proceeds for, say, financing the UN and paying for development projects in poor countries. This idea can be ruled out immediately since it would allow the industrialised nations that have caused the warming problem and have become rich through their overuse of fossil fuel to continue to use the lion's share. Moreover, it would lead to a very top-down pattern of development.

Or should we say, as the Americans once did, that the annual tonnage should be grandfathered – that is, shared according to the amount of emissions that each country is releasing now? This would force all countries to cut their emissions at the same rate – perhaps 5% a year – as the annual allocation was cut year by year until a balance between the emissions and the capacity of the sinks to absorb them was reached. This approach would, of course, mean that those countries which use most fossil fuel now would continue to use most in future while those using very little at present and which have not caused the climate-change problem would have to learn to manage on even less. Such an arrangement would scarcely command worldwide support.

The third option would be to say, as a growing number of countries now do, that the right to emit carbon dioxide should be considered a human right and that annual emissions permits should therefore be issued to all humankind on an equal basis. Contraction and Convergence, an allocation system advanced over the past ten years by the Global Commons Institute in London, is based on this idea. Under it, annual global emission limits would be set on a rolling basis for at least two decades ahead so that industry could plan. The level of emissions allowed would decline steadily over the planning period and, each year, permits giving the right to burn whatever amount of fossil fuel the year's limit represented would be shared out among the nations of the world according to their populations.

In the early stages of this emissions contraction process, some nations would find themselves consuming less than their allocation and others more. An essential part of C&C is that the under-consumers have the right to sell their surplus to more energy-intensive lands. This feature of the scheme provides an income for some of the poorest countries in the world and gives them (and the over-consumers) a financial incentive to follow low-energy development paths. Eventually, however, it is likely that most countries will converge on similar levels of fossil energy use per head.

Three things should be noted about allocating emissions permits in this way. One is that since the emissions rights are human rights, the permits go to individuals, not to their governments, which merely oversee their distribution. This may seem a cumbersome arrangement but its intention is to keep the purchasing power the permits represent out of the hands of corrupt elites. This will be very difficult to do, particularly in those countries where the corrupt elite and the government are one and the same. To beat this, the international agency issuing the permits will have to have a team of monitors, just like those used to check on the fairness of elections, and, if widespread abuse is detected, the country concerned would get a reduced allocation of permits the following year.

Issuing permits to individuals is also essential because it avoids the extreme hardship that restrictions on fossil energy use would otherwise cause. After all, when energy becomes scarce, its price will go up and this will increase the cost of everything everybody buys, including food. People already on the brink of starvation would face disaster unless they had emissions permits to sell to compensate.

The permits will, in fact, amount to a global Citizens' Income. They are a step towards economic democracy. Imagine Indian farmers dressed in white, queuing up in the hot sun outside the local district office to receive their permits and, when they reach the officials' table, having their hands stamped with indelible ink to ensure they don't queue up again. Dealers would set up booths ready to buy the permits when the recipients came out and most of the farmers would immediately sell theirs for rupees. The dealers would then sell the permits on to companies wishing to buy oil, gas or coal.

The second point is that if permits are issued to people rather than to governments, and if each child coming into the world consequently brought an income with it, families would have an incentive to have more children. To avoid this, emissions permits would only be issued to adults. Moreover, to ensure that governments continued with population limitation programmes, the share that each country got of the year's global issue of emissions permits would be based on its population in a base year, not its actual population at the time. A state agency would then divide the national share among the adult population.

This makes the choice of the base year a crucial issue but one on which C&C provides scope for negotiation. 1990 is the base year used in many climate negotiations – Kyoto, for example – but if that year were chosen for C&C it would discriminate against countries with young populations where, whatever their governments do, numbers are bound to grow because so many young women have yet to have children. Such countries will naturally wish to see a later base year adopted. If they succeed, countries with stable or shrinking populations will get somewhat smaller emissions shares.

The third point also provides scope for negotiation. It is that people in different countries probably won't get the same allocation of emissions permits straight away. In other words, the goal of equal per capita entitlements may only be achieved over a period of time, say ten or twenty years. This is not a matter of principle – it's just practical politics. An immediate convergence on the same allocation would be very costly for the industrialised nations as, in order to keep their energy-intensive systems running until they could be changed, they would have to buy many more permits from the poorer parts of the world. The burden that these purchases would place on rich-country economies might be more than they could bear – politically, at least – and this aspect of C&C was developed to allow negotiators from the industrialised world a little wriggle room. True, delaying convergence to equal per capita emission rights introduces an element of grandfathering to the system. However, without such a concession to rich countries to ease their transition to strict C&C, they might never sign up.

C&C is the climate protection arrangement most likely to be adopted by the world community to follow on from the *ad hoc* Kyoto Protocol arrangements. It is therefore highly desirable that the measures to control emissions being put into place in Ireland and the EU now be compatible with such a system.

To achieve this, Ireland should be dividing the total tonnage of carbon dioxide it is allowed to emit under the agreement it reached with its EU partners under the Kyoto arrangements – its 1990 emissions plus 13% - by its current population and issuing permits for that amount – roughly 15.5 tonnes of CO2 per head - to the population, perhaps at the rate of 1.3 tonnes each month. We would all take our permits to the bank or the post office and sell them for whatever they were worth that month in euros. The banks would then resell the permits, just as if they were foreign exchange, to domestic fossil fuel producers and to importers who would be required to acquire them for the release of every tonne of CO2 their activities involved. So the ESB, for example, would need to buy permits for all the coal, oil and gas it burned in its power stations, while the petrol distribution companies would need to hand over permits for every gallon they purchased for re-sale. The price that we would receive for our permits would vary according to the demand for fossil energy and just how well Ireland and the rest of the EU were doing in getting emission levels down. If the EU economy was booming and a lot of energy was being used, the price of the permits would be high but, equally, so would be the price of our petrol, electricity and home-heating oil. If the economy was depressed, these prices, and the amount we got for our permits, would fall. This builds an automatic cushion against higher energy prices into the system, which protects, in particular, the least well-off who, although they spend a greater proportion of their incomes on energy, spend less on it in absolute terms. The provision of this cushion is very important since, as energy is used in the production of everything we use and consume, all prices will go up as a result of any restrictions on energy use.

The proceeds from the permit sales should provide the average person with enough extra purchasing power to cover the higher costs of the fuels and (because of the higher energy prices) the other goods and services they buy, provided that their purchases are not excessively energy-intensive. However, if some individuals were able to cut their direct and indirect fuel use below their entitlement, they would make themselves better off. On the other hand, if they continued to drive around a lot in their SUVs, they would have to pay more frugal people for the privilege. The fact that fossil fuels themselves and goods made with significant amounts of fossil energy would cost more would encourage people to find lower-fossil-energy alternatives and enable the transition to renewable energy sources to gather pace. In short, a quota system would give people the price signals to move in the right direction.

Domestic Tradable Quotas

A British economist, David Fleming, has proposed a rather more sophisticated method of issuing emissions permits to individuals than that suggested here. He would like to see emissions permits covering about 55% of a country's allowable level of emissions being auctioned off to industry and transport companies because that percentage is roughly the proportion of a country's total fossil energy use taken up by these sectors. The income from these permit sales would go to government, which could pass some of it on to the less-well-off to compensate them for the higher prices they would have to pay for almost everything they bought. Part of the remaining permit sales income could be spent on developing renewable energy sources.

The remaining 45% of emissions would be shared equally amongst the country's residents in the form of Domestic Tradable Quotas (DTQs). Each person might receive their carbon emissions allocation in units on a chip-card which they could use, along with cash, whenever they were buying electricity, petrol or some other fuel. The required number of carbon units would be deducted electronically from the amount on the card, which would act as a purse. They would also be able to sell units from the card for cash, or buy additional ones in exactly the same way that you can top up the call units on a pre-paid mobile phone.

However, there would only be any point in issuing emissions permits on chip cards, with all the expense and trouble involved, if it caused people to behave differently from the way they would if they simply got their allocation as a voucher which they then sold to their bank. Fleming expects that many chip card recipients would set out to live within their allocation and make it a matter of pride not to have to buy extra units during the course of the year. If so, they would become very fossil-energy-use conscious, which ought to accelerate the transition away from such fuels, thus justifying the expense of setting up the system and running it. Research is required to determine whether or not this is the case.

Unfortunately, however, the government has not taken this equal-shares-for-all approach. Instead, the EU insisted that it adopt what must be almost the most mis-conceived quota scheme imaginable.

Under this, the government has to give – rather than sell - permits to the country's most energy-intensive companies in the power generation, oil refining, smelting, cement, ceramics, glass and paper sectors. Quite why the EU insisted on the permits being given away is unclear as no economist would recommend it. Presumably, naïve politicians were persuaded by corporate lobbyists to believe that, if the permits were given out rather than sold, it would enable electricity, cement and the rest to be cheaper. Not so. The fact is that the permits will acquire a market value if the industries covered by the scheme increase their output faster than they restrict their greenhouse emissions. And once the permits can be sold, firms will factor in the price they could have obtained by selling them as the cost of using them in their production process. In other words, even though the necessary permits came free, the price of electricity and cement will still go up by just as much as would have been the case if the permits had been sold to them by the state. The only difference is that the companies receiving the permits will make a big windfall gain, while the state will not have the revenue it will need to compensate the less-well-off for the higher prices they will have to pay. Fortunately, this scheme runs for only three years and there is some chance – not a big one because it has already been announced that 90% of the permits will be given away in the next three-year period – of changing it after that.

The free permits constitute a massive subsidy to the industries concerned. John Fitz Gerald of the ESRI, in a strong attack[4] on the arrangement, estimates that they would be worth €1,350 million if the price being put on the right to emit a tonne of CO_2 rises to €20. This is money which could have gone to Irish residents. Moreover, the fact that it has been announced that the permits will be given away next time encourages the owners of polluting plants to keep them open so that they can benefit from the subsidy again. If the plants had had to buy the permits, however, the dirtiest ones would have had to close.

[4] 'An Expensive Way to Combat Global Warming: Reform Needed in the EU Emissions Trading Regime', special article in the ESRI's *Quarterly Economic Commentary*, April, 2004. Can be downloaded from http://www.esri.ie/pdf/QEC0404_FitzGerald.pdf

The permits will also encourage the construction of more fossil-fuel power plants rather than the development of renewable energy sources. This is because, although wind farms will benefit from the higher electricity prices that will result from the permit scheme, so will the promoters of, say, new gas-fired power stations, because they will be given the permits they require to buy their fuel. This will, effectively, reduce the costs of constructing their new power station. “For a new combined cycle gas turbine electricity generator, the subsidy in the period 2005-2012 could amount to at least 50% of the capital cost of the new plant” Fitz Gerald says.

All told, the big energy consumers have been handed roughly one third of Ireland’s annual emissions allocation. Until last month (September 2004) the government was proposing to use a carbon tax to get the smaller emitters –that’s everyone else - to reduce emissions but it wisely scrapped the tax since it would have fallen most heavily on the least well-off who would have needed to be compensated through social welfare payments and the income tax system for their losses. This would have been messy. Minister McCreevy probably remembered what happened when his British counterpart Norman Lamont tried to phase in VAT on domestic fuels in 1993 only for the measures to be rejected when MPs of his own party voted against them despite his and his successor’s efforts to protect the less-well-off through social welfare increases.

In a report[5] published by the Environmental Protection Agency in July 2004, Sue Scott and John Eakins, both of the ESRI, found that the average low-income household would need to receive compensation of €246 a year through the Social Welfare system or in reduced income tax if it was not to be worse off as a result of a carbon tax set at €20 per tonne. The €246 estimate covers just the first-round price increases, € that is, the immediate effects of the carbon tax. When the knock-on effects of the first round price increases had been reflected in a second round of price rises, and those in turn had been used to justify a third, and so on, the compensation would have to be higher still.

[5] *Carbon Taxes: Which Households Gain or Lose?* Environmental Protection Agency, PO Box 3000, Johnstown Castle, Co. Wexford, Ireland.

With the carbon tax out of the way, Ireland should be able to avoid running two incompatible CO2 emissions control measures – the carbon tax on small emitters and the EU-imposed quota system for large ones – side by side. It can now opt for an all-quota arrangement, a huge advantage since carbon taxes, however they are structured, cannot guarantee that any particular level of emissions will be achieved at any given date in the future whereas a quota can.

This is because a carbon tax rate which would bring about the required emissions reduction in a booming economy would be too high and thus have a depressing effect on a depressed one. As a result, for a carbon tax to work well, its rate has to be adjusted regularly to conform with the stages of the business cycle. This makes setting the rate a perennial source of conflict between the government, the consumer and business interests. With a quota, however, the market automatically sets the price to be paid for permits giving the right to burn extra fossil fuel and leaves no scope for argument.

The best course for Ireland to take now is therefore for it to give emissions permits to each resident for the two-thirds of their allocation that has not been given to the big emitters and for trading in these permits to begin. Residents should also be paid for their missing permits and the government should seek to recoup the money this will cost it by imposing a windfall tax on the companies to whom the permits were given. If this is prevented by the EU, the payments should be funded from another source. The result? By adjusting the number of permits it issued each year, the government would be able to bring Ireland’s emissions down to whatever level it chose without damaging the less-well-off.

Quotas can, of course, be used to control other types of demand apart from that for the right to emit. For example, if a local authority was worried that it had inadequate reservoir capacity to meet rising water demand, it could allocate a share of the available capacity to every resident and auction the remainder to commercial users. Residents would be able to use their vouchers to pay for whatever amount of water they drew and if they had surplus vouchers after that, they would be able to sell them at the price determined by the commercial auctions to people or companies who had too few.

Much the same sort of arrangement could be applied to waste disposal arrangements in local authority areas where landfill sites are becoming scarce. Households could be issued each year with a limited number of stickers for refuse sacks and additional ones could be sold to members of the public who could not manage on the number they were given and also for use with commercial waste. The total amount of stickers issued in the course of a year – and hence the price at which they sold - would be adjusted so that it prolonged the landfill's capacity until alternative arrangements could be made.

Everybody needs access to water and a means of waste disposal and in both the cases we have just discussed, they would be provided with this by being given an individual quota. However, the local authority would also be able to generate an income by selling the remainder of the available capacity to commercial and more lavish private users. The alternative method of controlling demand would be to raise water and waste-disposal charges to everyone. This would be seen as a tax and, moreover, one which hit the less-well-off most severely. Some sort of compensation measures would be demanded but these would be complicated to bring about.

In summary, taxes can be useful in reducing demand for such things as road space, plastic bags, chewing gum and non-returnable bottles. The characteristics that all these items share is that no one has to use them to survive and it does not matter too much if the desirable usage limit is exceeded. However, whenever it is critical that the pressure being put on a resource stays below a particular limit, quotas should be used instead because of the much greater certainty they provide that the limit will not be breached. In addition, if people find it essential to use a particular resource, a quota gives much more scope than a tax for protecting the welfare of the less-well-off.

3.2

Refundable tax credits

Colm Rapple

There are 1.7 million earners on the Revenue's books but only 1.2 million of them pay income tax. Some of the other half million may be high earners availing of tax avoidance plans but the bulk of them are simply not earning enough to be liable for tax.

Finance ministers like to boast of taking people out of the tax net but most of these non-tax-payers would prefer to be liable for income tax – and the more tax the better. The greater their tax liability the more they'd be earning. And as an added benefit, if they were paying tax they could benefit from tax reductions in the budget. You can't benefit from an income tax cut if you don't pay tax.

Indeed those who are removed from the tax net each year as a result of increases in tax credits or exemption limits are actually hard done by. It follows that if they are removed from the tax net, they haven't got the full benefit of the tax cuts – unless by chance they happen to be just on the margin. If you are only paying €100 a year, that is the most you can gain from any increase in tax credits

Someone who has no liability to tax, of course, gets no benefit at all from an increase in tax credits. And at last count – the tax year 2000/2001 – there were almost 500,000 such low earners on the Revenue's books.

The situation would be different, of course, if tax credits were refundable. But as yet they are not although such a change has been proposed by ICTU in pre-budget submissions and by the Green Paper in its last pre-election manifesto.

There is an easy solution to the difficulty. Tax credits could be made refundable and used, as at present, to reduce tax liability, or alternatively cashed in for a direct payment by non-taxpayers. It's not likely to happen in the 2005 budget but the change is long overdue. But, of course, simply changing the tax system to ensure that the benefits of tax concessions are more equitably spread won't, of itself, alter the fact that income is spread very inequitably in our society.

Between them the 1.7 million earners on the Revenue's books in 2000/2001 declared total income of €41.6 billion and paid just under 19 per cent of their income, €7.8 billion, in income tax. A quarter of those income earners at the bottom of the scale accounted for less than 5 per cent of the total income. At the other end of the scale the top 6 per cent of earners shared over a quarter of the total income between them.

The bottom half of income earners shared 18 per cent of the total income between them while the top half got the other 82 per cent.

A more equitable tax system could help to redress the balance.

3.3

Individualisation: Fables and Facts

Tim Callan

Introduction

The introduction of what was termed "individualisation" of the standard rate tax band in Budget 2000 led to a heated debate about the merits or otherwise of the proposal. Much of this debate centred on issues of fairness or equity – both vertical equity (as between persons at different points on the income scale) and horizontal equity (equal treatment of equals, or no unwarranted discrimination). Some of the disagreements had to do with deeply held value judgements. But other disagreements arose from the lack of a common understanding of the facts of the situation. In these circumstances a number of myths or fables held sway. The time is now ripe for a cooler look at the issues, to disentangle facts from fables, and see what can be learned from this experience and put to use in shaping a future tax policy that will contribute to fairness and economic prosperity.

Individualisation and Family Policy

During the debate about individualisation there was a tendency to view the pre-reform tax treatment of married couples – which involved full transferability of bands and allowances - as a system that was "pro-family".[1] By contrast, the new individualisation arrangements were characterised as being "anti-family" in their effect. On this view,

[1] The system could also be described as one involving "income-splitting", or doubled personal allowances and rate bands for married couples.

individualisation is associated with individualism,[2] whereas a family-centred policy must involve full transferability of allowances and bands between husbands and wives.

Let us tease out some of the elements underlying this approach. The introduction of the income-splitting or full-transferability system represented a response to a Supreme Court judgement in the Murphy case. This declared the previous (joint taxation) system to be discriminatory against two-earner couples, and unconstitutional. The reason given in the 1980 Budget Speech for the decision to move to full transferability was that

> "A narrow approach towards effecting the Supreme Court's decision would lead to unjustifiable discrimination against the one-income family, particularly where a married woman elects to care for the family on a full-time basis at home rather than take up work outside the home".

This can be viewed as putting the emphasis on the provision of a tax subsidy for childcare undertaken by married women in the home. But, as Callan and Farrell (1991) point out, the subsidy "is not conditional on having children, but simply on marital status". This means that the benefit from this tax subsidy is, in terms of its main stated objective, rather inefficiently targeted. Fahey's (1998) analysis of Labour Force Survey data found that "many who receive the subvention are not engaged in childcare and many of those with young children who have a heavy childcare burden do not receive the subvention". He suggested that alternative uses of the resources – including the possibility of a greatly increased Child Benefit – could "serve the purposes of family policy a great deal more effectively and efficiently than does the present approach, as far as income tax and married couples are concerned".

[2] This view is expressed by, among others, the former Taoiseach John Bruton, who referred to "pure individualism, and its associated political programme of individualisation" in a speech of 16 August 2004 (Fine Gael website).

These considerations suggest that individualisation does not necessarily involve an orientation towards individualism. Individualisation can form part of a package of measures reorienting and strengthening support for families. The retention of full transferability could be an inefficient and ill-targeted use of resources. Much depends, therefore, on the make-up of the overall package of which individualisation forms a part – something considered in the final section of the paper.

Individualisation and Married Women's Labour Market Participation

Improving the financial incentive for married women to take up employment was one of the explicit aims of the individualisation measure. One of the most heated elements of the debate concerned whether or not this would represent a good outcome for Irish society. "Individualisation is a naked attempt to increase female participation in the labour force and to coerce women, who might otherwise opt to work at home while their children are young, into the labour force." (Deputy J. Mitchell, Dáil Debates, 27 February 2001). There was little discussion of exactly how much of an increase in female participation might be expected, but the impression gained from some of those opposed to individualisation was that a great many women would be "forced into the labour market" as they put it.

It is interesting in this context to look at how the labour force participation rate for married women has evolved over time, both before and after the introduction of individualisation. Figure 1 shows the participation rate for married women from 1971 to 1999, and from 2000 to 2003. There is a strong upward trend in participation, but no evidence of an acceleration associated with the introduction of individualisation. Of course, it could be that participation would have "flattened out" in the absence of individualisation, or that the full response to the tax changes is not yet apparent.

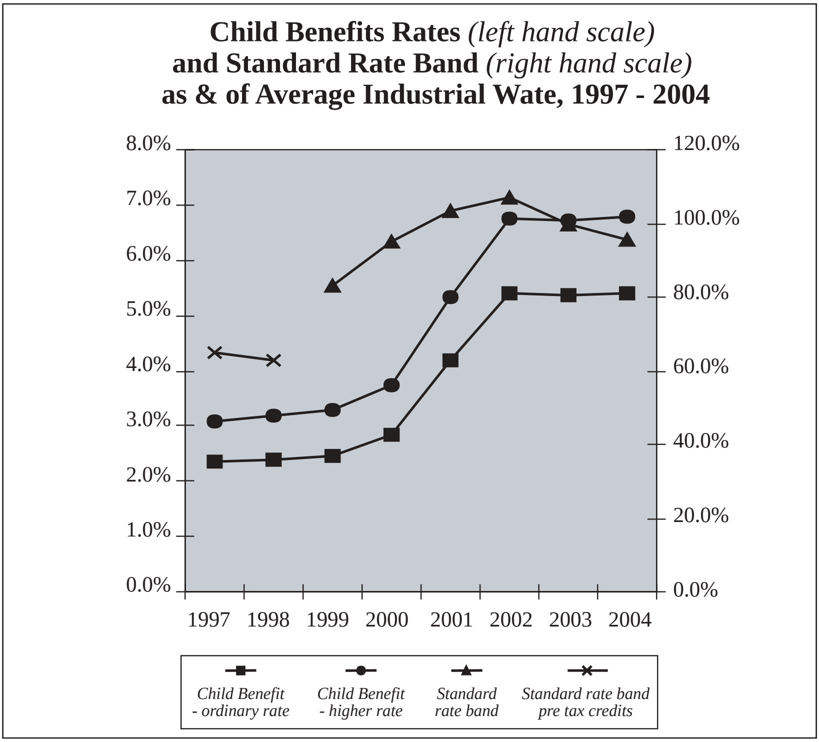
The study by Callan, van Soest and Walsh (2003) examined this issue in considerable depth, estimating and simulating behavioural responses to the tax changes. Their results suggest that a package involving full individualisation of tax bands, and a revenue-neutral reduction in tax rates, would lead to a rise in married women's participation of between 2 and 3 percentage points. While this represented a stronger response than that to standard forms of tax cut (rate cuts, increased allowances or band widening) it should be remembered that the actual package introduced included provisions for a Home Carer's Allowance, and only partial individualisation of the bands. For these reasons it is clear that the impact of individualisation on married women's participation rates can be expected to be quite modest, compared with the strong upward trend over the past thirty years.

Figure 1

Individualisation and the Distribution of Income

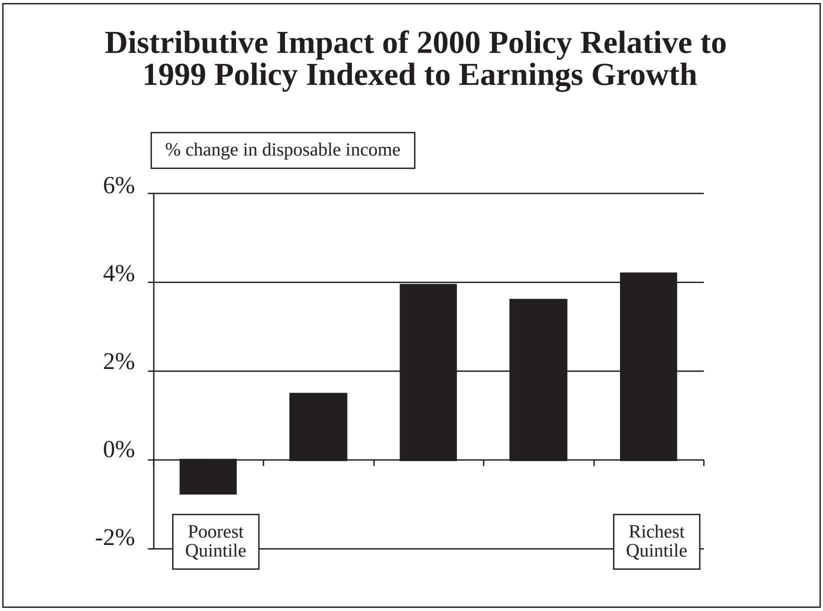
The first stage of individualisation involved not just a structural change in the treatment of couples, but a substantial widening of the standard rate band for single people and two-earner couples. In subsequent years, there was some further widening of the band, but also very substantial increases in child benefit. Figure 2 illustrates the evolution of child benefit rates and the standard rate band in relation to the average industrial wage.

Figure 2



Evaluation of the impact of "individualisation" depends critically on what benchmark is used to assess the impact. I have argued elsewhere that a "distributionally neutral" benchmark, provided by a wage indexed budget, is of considerable value.

Figure 3:

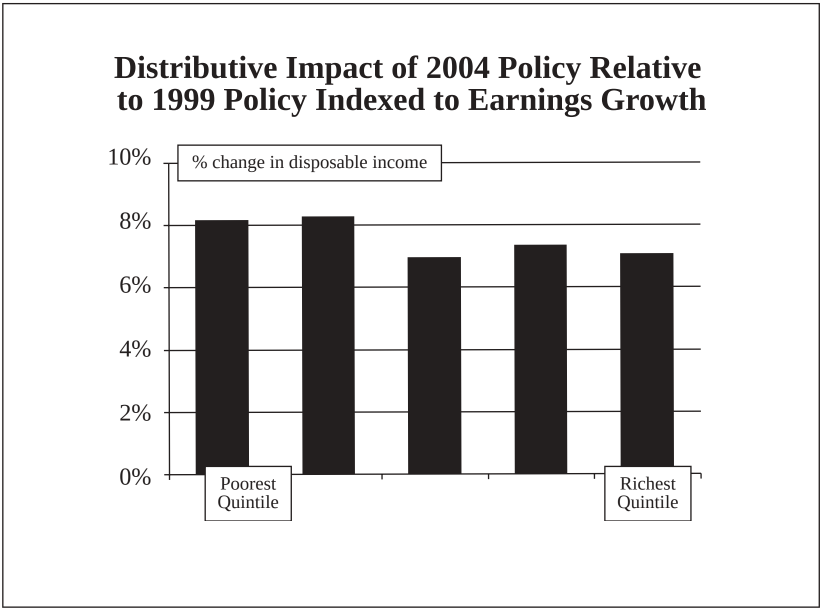


Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or "quintiles"

Here I provide two pictures of the impact of individualisation. The first (Figure 3) is simply the impact of Budget 2000, in which individualisation was introduced. It shows that the benefits of Budget 2000's tax and welfare package were skewed towards middle and upper income groups.

The second (Figure 4) is the impact of Budget 2004 assessed against the pre-individualisation policy (Budget 1999) indexed in line with wage growth. This allows an assessment of individualisation in the context of the overall policy package which has evolved over the past three or four years. The net effect is very even across the income distribution, with a slight "pro-poor" bias.

Figure 4:



Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or “quintiles”

Conclusion

There are many lessons to be learned from the individualisation process and the associated debate. There is a clear need for accurate and timely information on the likely impacts of policy changes in order to allow informed debate and guide policy choices. Tax and welfare policy packages will often combine regressive and progressive elements. It is important to keep the overall effects of tax and welfare policy on income distribution, the labour market and the macroeconomy in mind.

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4

Towards a Fairer Tax System for the 21st Century

4

Towards a Fairer Tax System for the 21st Century

Seán Healy and Brigid Reynolds

Guiding Vision for Society

Policy formulation is based on a vision of what is to be achieved. Taxation policy is particularly important in this context since its outcomes have major influence on the shape of society. At the outset we need to address the issue of a guiding vision for society. Tax policy should then be in the service of this vision.

In its 1999 Strategy report[1], the National Economic and Social Council (NESC) proposed a vision for Ireland. It argued that the foundations of a successful society are:

- A dynamic economy;
- A participatory society;
- Incorporating a commitment to social justice;
- Based on consistent economic development that is socially and environmentally sustainable; and
- Responds especially to the constantly evolving requirements of international competitiveness, understood as the necessary condition of continuing economic and social success.

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[1] National Economic and Social Council, 1999, *Opportunities, Challenges and Capacities for Choice,* pp.48-49.

This vision had several dimensions, the most important of which were:

- Economic inclusion based on full employment;
- Social inclusion, reflecting full participation in those activities which constitute the norm in society;
- Successful and continuing adaptation to change;
- Commitment to the utilisation and development of the potential of the Information Society and the promotion of research and development;
- Commitment to lifelong learning;
- Environmentally sustainable and balanced development between regions and between urban and rural areas;
- Commitment to the further development of the European Union and international solidarity; and
- An entrepreneurial culture.

The Council also pointed out that the realisation of its vision would have a number of practical beneficial consequences for individuals and for society. These would include:

- Every child would leave primary school literate and numerate;
- Every student would complete a second cycle programme appropriate to the individual's capacity and interests;
- Every person seeking employment would be equipped with the personal skills and supports to find satisfying employment at reasonable rates of pay;
- Every person would have access to lifelong learning, a sense of personal security in a changing work environment, an opportunity to balance work and family commitments and a capacity to share the gains made by successful competitive firms and high performance public bodies;
- Every family would have access to healthcare, affordable housing appropriate to their needs, good quality childcare and a well functioning public transport system;

- Every firm would have the capacity to compete effectively in the global market place, through enhanced partnership with their employees and a supportive business environment backed up by an appropriate macroeconomic policy;
- Every region would have an efficient physical infrastructure to support sustainable economic activity, and promote social cohesion, based on a balance between urban and rural needs;
- Disadvantaged communities would have received the benefits of an investment programme and more responsive public services to overcome the accumulated burden of unemployment and marginalisation; and
- Average living standards (GNP per capita) would have exceeded the EU average, those dependent on transfer payments would share in the increased affluence and a reduced rate of poverty would ensure a more widespread participation in the lifestyle of a mature developed economy.

In its next strategy report, published in 2003,[2] NESC reiterated its support for this vision arguing that a successful society is one in which individuals, families, associations and communities, whether geographical or interest based, can flourish and in which the public system enables them to achieve their goals. NESC went on to state that it should be clear from this account of a successful society that equality is one of the central concerns of the Council: equality of educational service and opportunity, of access to training and employment opportunities, of chances to balance work and family life, of access to the key services that assist well-being, of local and regional infrastructure, in short, equality of status in access to the services of the public system. NESC identified its major challenges as identifying what would be necessary to achieve the outcomes listed above and to build a consensus to meet these requirements.

[2] National Economic and Social Council, 2003, *An Investment in Quality: Services, Inclusion and Enterprise*, p. 141.

The great strength of this statement is that it has been agreed by the Social Partners and Government. As such we welcome it while recognising its shortcomings. We recognise, for example, that it is not a fully rounded vision for the future of Ireland and is weak on a number of issues, particularly regarding poor people's income. It fails to address directly the need for balance between economic and social progress. Too often the parameters of social development are based on an economic model of progress. If it were to be a fully-rounded vision statement for Ireland it would need to include cultural and participation dimensions that are missing from the present statement. Yet, despite its limitations, it is a vision of Ireland's future that we support in so far as it goes. It was produced after much discussion between Social Partners, Government and others and commands wide support. We repeat it here because it is our contention that the development of taxation policy and all other aspects of public policy should be guided by a vision of Ireland in the future. Policy should be aimed at achieving specific outcomes. If the outcomes listed in the NESC report were achieved they would certainly constitute both social and economic progress.

When the present authors approach these issues we are guided by Christian values. The Catholic Social Thought tradition subscribes to the values of both human dignity and the centrality of the community. The person is seen as growing and developing in a context that includes other people and the environment. Justice is understood in terms of relationships. The Christian scriptures understand justice as a harmony that comes from fidelity to right relationships with God, people and the environment. A just society is one that is structured in such a way as to promote these right relationships so that human rights are respected, human dignity is protected, human development is facilitated and the environment is respected and protected.[3]

3 Cf. Healy, S. and B. Reynolds (2003) "Christian Critique of Economic Policy and Practice" in J.P. Mackey and E. McDonagh (eds.) *Religion and Politics in Ireland at the turn of the Millennium*, Dublin, Columba Press.

As our societies have grown in sophistication, the need for appropriate structures has become more urgent. If these structures are to emerge it is important that society have an aspiration that everyone should enjoy the good life. Likewise it is essential that there be a commitment to make the good life available to all. However, if we wish to have a just society which aims to provide access to the good life for all we must realise it will not happen without the deliberate establishment of structures to facilitate its development. In the past charity, in the sense of alms-giving by some individuals on an arbitrary and ad hoc basis, was seen as sufficient to ensure that everyone could cross the threshold of human dignity. Calling on the work of social historians it could be argued that charity in this sense was never an appropriate method for dealing with poverty. Certainly it is not a suitable methodology for dealing with the problems of today. Appropriate structures are required to ensure that every person has access to the resources needed to live life with dignity. Taxation policy is a core dimension of such appropriate structures.

The outcomes listed in the NESC vision statement noted above would move Ireland a lot closer to the just society we envisage. Consequently, we believe this vision would be of value in guiding Ireland's policy development in the years immediately ahead while recognising the need for further dimensions to be added as already noted. In this paper we focus specifically on the area of taxation policy.

Guiding Principles for Taxation Policy

Taxation must be seen in the context of Government's responsibility to ensure that the rights of community and the common good are respected. A working definition of taxes is that they are obligatory levies on the persons (physical and moral) who make up the state to enable the Government of a State to fulfil its duty of safeguarding and promoting the common good. It follows immediately from this that while taxes provide the funding for public services and infrastructure they are not payments for services received from the State. This is important to realise as often people complain that they receive little benefit from the money they pay in taxation. Nor are taxes a voluntary or philanthropic contribution to the State. Rather, as Robert Noonan argues, taxes are “levies on persons who form the State so that the Government of the day can fulfil its obligation of promoting the common good”.[4] Noonan goes on in his paper to address the issue of guiding principles. He states that “a just assessment is founded on two basic principles: the real need of the State and the relative capacity of the individual persons (be they physical persons or corporations) to pay the tax. Three other principles then govern the actual assessment: (1) all taxes must be imposed by legitimate authority; (2) taxes must be within the limits of taxable capacity; (3) taxes must be equitably distributed. And here the equality demanded is a proportional equality. Those who have more pay more; and those who have less pay less. That is only just.”[5]

The Commission on Taxation addressed the issue of principles or criteria to guide taxation policy in the first of its five reports[6] published in 1982. While the report is dated in terms of its descriptions of the tax system its discussion of issues such as those being addressed in this section is very worthwhile. It identified three key criteria that should guide the tax system. These were:

- Equity
- Efficiency
- Simplicity

[4] Noonan, R. *Justice Day by Day: Taxation*, The Furrow, Vol. 40, no. 4, April 1989, pp. 210ff.
[5] ibid. p. 210
[6] Commission on Taxation, 1982, First Report: *Direct Taxation*, Stationery Office, Dublin.

On the issue of equity it acknowledges both horizontal and vertical equity and recognises that it may be difficult to deliver a fully equitable system in practice. In its discussion of equity it rejects the notion that all taxes constitute a diminution of welfare for which the citizen receives nothing in return and states that taxation is a necessary means of providing public services to the community.

On the issue of efficiency the Commission argues that the tax system should not be subject to frequent and fundamental changes and this, in turn, depends on finding a structure of taxation which is broadly acceptable to different political opinions but which is flexible enough in its rate structure and detailed operation to enable different emphases to be put on different tax objectives from time to time.

In its discussion of simplicity the Commission argues that simplicity in a tax system is achieved if the administrative costs of tax collection are small and if the compliance costs for the taxpayer both in terms of money and mental effort are also small. It goes on to argue that a tax system must be acceptable to the public and to be acceptable it must be understandable. Furthermore, if a tax system is based on simple, clear-cut principles any concessions to special interests will be highlighted.

Twenty one years after the Commission on Taxation produced this outline of criteria to be followed in developing a tax system NESC, in its strategy report[7], proposed that the following principles should inform the evolution of the tax system:

- The tax system should facilitate economic growth and employment creation and, in particular, should not act as a disincentive to those on low incomes to take up employment;
- The tax system should be fair. There are two dimensions to fairness or equity. Horizontal equity means that people in similar circumstances on the same income should pay the same amount of tax. Vertical equity means that people on higher incomes should pay more tax;

7 NESC 2003, pp. 290-291.

- Tax bases should be as comprehensive as possible;
- The tax system, at a minimum, should not make it more difficult for firms to compete in domestic and international markets;
- Income from different sources - whether employment, self-employment, investment, or social welfare - should, as far as is practical, be taxed in an equivalent way;
- The tax system should only be used to influence personal or business choices where there is a clearly defined justification for doing so, and where the tax system is an effective instrument for achieving this. Departures from neutrality should only take place where there are well defined externalities and where the benefits exceed the costs;
- Administrative and compliance costs should be minimised;
- The system of taxation needs to be able to adapt to changing economic circumstances; and
- The Council supports the continuation of earmarked social security contributions, but believes that compulsory social insurance contributions should be evaluated using the same criteria that apply to the evaluation of taxes.

The NESC principles are, in effect, consistent with and an expansion on the criteria outlined by the Commission on Taxation.

Writing on this issue fifteen years ago[8] the present authors identified the following principles:

- When sufficient resources exist within a State to enable everyone to live life with basic dignity then the income from taxation should be such as to ensure that the State is provided with a sufficiency of those resources to ensure that all, especially the least advantaged members of society, have these necessary resources.

8 CMRS, 1989, S. Healy and B. Reynolds, “Justice, Taxation and Poverty” in B. Reynolds and S. Healy (eds.) *Poverty and Taxation Policy*, pp. 56-7.

- Every person (physical or corporate) has an obligation in justice to pay the tax required by the State to ensure that all citizens can live life with basic dignity.
- A tax structure is unjust if it is organised in such a way as to benefit the better off. Every person (physical or corporate) has an obligation in justice to pay an equitable proportion of tax. The better off should pay more, those with less should pay less.
- These are serious moral questions concerning an apparently endless variety of tax avoidance schemes which have emerged in Ireland in recent times. These schemes are designed to ensure that those who have more resources pay less tax. As such they are unjust.
- Government has the responsibility to ensure that the tax structure is just so that it meets the requirements demanded by the conclusions listed in the four preceding points.

We stand by the principles we outlined fifteen years ago. If these had been followed in the intervening years Ireland would be a much fairer place today and Irish society would be much more just. For example:

- The least advantaged members of society have not been provided with the minimum resources necessary to live life with dignity.
- The tax system still benefits the better off more than those on lower incomes.
- There are a range of tax avoidance schemes which enable those with more income to avoid their full tax liability.
- While there have been many improvements since the early 1980s Government still has some way to go before it can validly claim that the tax system is just.

We believe these principles are still valid and can provide a way forward in addressing some of the justice issues arising in the present taxation system.

Challenges for taxation policy in pursuit of the guiding vision

There are a number of challenges that face Ireland at present that must be taken into account as the tax system is being analysed and/or updated and/or improved. Here we raise some of the issues we consider to be among the main challenges to be faced in the years immediately ahead.

- **Globalisation**

In a single generation we have seen the emergence of globalisation which has emphasised global economic interdependence. It has arisen from the quantum leap taken by technology and the determination, demonstrated by political decisions, to open national economies internally and eternally to competition. This is a process that will continue. To date, globalisation has brought improvements and opportunities for many people in many parts of the world. However, many others have not gained from its development. These people have become more excluded and marginalised than was the case previously.

Many of the problems that flow from globalisation are connected to the fact that the major actors have been motivated principally by their own specific interest. They have little or no understanding of or commitment to the common good. Global governance is the key to ensuring that globalisation is a positive process that benefits all and whose negative aspects are eliminated. Taxation policy is a key area in this context. Without governance that extends beyond the nation state, it is most likely that taxation policy will simply be a race to the bottom where the corporate sector is concerned. To date we have seen little that suggests that this issue is being addressed by the Irish Government. In fact, a strong case could be made that the opposite is the case - i.e. that Irish Government policy is happily cooperating in a process that will logically eliminate all corporate taxation.

- **Demographic changes**

Ireland's population is growing rapidly and is becoming much more concentrated in the greater Dublin area. In 1971 the population of Ireland was 2,978,000. The 2002 census shows it has grown by 31.5 per cent since then and now stands at 3,917,000. It is also aging and the dependency ratio will increase dramatically in the coming decades as the proportion of the population in the labour force declines steadily. The projections for the elderly dependency ratio in 2026 vary from 25.6 per cent to 29.0 per cent. These compare with ratios of 18.5 per cent in 1991 and 17.6 per cent in 1996.

Projections by the Central Statistics Office (based on 1996 Census figures) estimate that the population of the Dublin region will grow by over half a million people in the period to 2031. This increase will be due to natural increase, international migration and internal migration from the other regions of the country. According to the CSO, the heaviest population losses due to internal migration will be in the Midland and Border areas. But these regions are seen as having an actual population increase over the period.

Again, these demographic changes have implications for taxation varying from the need for ensure that an older population will have the resources to live life to the full to the need to pay for the physical and social infrastructure required as the population of Dublin, for example, expands dramatically.

- **Family**

The situation of the family has changed dramatically in recent decades. Ireland's total fertility rate (TFR) has been below the level required for replacement of the current population (i.e. 2.18) since 1989. It is currently around 1.9 which places it in the top range of the EU-15. The CSO expects this trend to continue.[9] This decline has been paralleled

[9] Central Statistics Office, (1999), *Population and Labour Force Projections 2001-2031*, Dublin: Stationery Office, p. 11.

by major changes in Government policy towards families. These changes often manifest themselves in taxation policy. In a recent paper presented at an EU Presidency Conference on Family Policy, Professor Mary Daly argued that "It might be better for states to orient themselves to a broader set of policy 'goods', such as family solidarity (the propensity and capacity of people to defer gratification for the good of others or the collective unit)." Professor Daly went on to conclude that:

> "There are good grounds to question the extent to which current policy is generating family solidarity. While parental care has some place as a component of contemporary perceptions of solidarity, a dominant interpretation of family solidarity on the part of the state now is that parents should be prepared to entrust their children to others so that they themselves can be workers. This form of solidarity actually requires mothers and fathers to distance themselves from the care of their children. What we are seeing, then, is a process whereby the engineering of family solidarity by the state leads to a certain 'emptying' of the nuclear family of some of its caring and exchange activities. By subjecting families to state policies designed to shape behaviours in the direction of more market participation, more employment, more purchased or extra-familial (or indeed extra neighbourhood/social network) care for 'dependants', the state subjects more of social life to the logic of the market of calculation, of rationality thereby diminishing affect, emotion, and traditional norms."[10]

It is clear that a more integrated approach to policy making that affects families is required. Taxation policy is at the core of such an integrated approach. It appears to us that people's preferences should be given

[10] Mary Daly, 2004, *Unmet Needs and Risks: The Significance of Changing Family Life for Social Policy in Europe/EU*, paper presented at conference on 'Families, Change and Social Policy in Europe', Dublin May 13/14 2004.

priority in this context and that no policies in the taxation area should provide incentives that encourage [family break-up] families to divest some of their original activities. This is a situation in which the role played by a guiding vision is important and the purpose and impact of taxation policy can be clearly identified.

- **Labour market changes**

The labour force has grown dramatically over the past ten years; so too has the number of people employed. According to most economic analysts the ongoing needs of an expanding economy require increasing female participation in the labour force, ongoing participation by older people and substantial migration into Ireland in the years ahead. According to the ESRI Medium Term Review[11] the major part of the increase in employment will be in high skilled areas such health, education and in professional services sector such as banking, insurance as well as internationally traded services. These sectors require a skilled labour force. They will, according to the ESRI, account for 44.6 per cent of total employment in 2010 and 78 per cent of new jobs generated between 2003 and 2010. We repeat these numbers here because they point to the need for resources to ensure Ireland's labour force meets these needs. The increase in the labour force being sourced from abroad also has resource implications as the infrastructure required must be provided.

These all have implications for the tax system. If older people choose not to extend their participation beyond the usual retirement age of 65 and/or if many women decide to work in other roles outside the paid labour force, then migration may be higher than forecast at present. Either way there are implications for the tax system in terms of providing sufficient revenue to cover both infrastructure and social provision costs going forward.

[11] Adele Bergin, Joe Cullen, David Duffy, John Fitz Gerald, Ide Kearney, Daniel McCoy, 2003, *Medium-Term Review: 2003-2010*, The Economic and Social Research Institute, pp.50 ff.

- **Growing inequality**

Inequality is growing in Ireland. These inequalities are clearly manifest, for example, where income is concerned as the standard measure of income inequality (the Gini coefficient) has widened dramatically over the past decade. These inequalities are clearly seen also in areas such as health, education, housing, social mobility and geographical location. We have written extensively on these and related issues in other publications and do not intend to repeat our analysis. We simply refer to them here as they have implications for the taxation system. The growing inequality in these areas has been driven, in part at least, by the tax system. Tax changes have benefited the better off more than they benefited those on low incomes.

The market liberalism that underpins this approach to policy making is based on a strong belief in individualism. Eamon O'Shea and Brendan Kennelly developed this analysis in a recent publication.[12] They describe this approach as follows:

> "It argues that consumer sovereignty should be respected as much as possible, that individuals are the best judges of their own welfare (or well-being) and that they have every right to spend their money as they see fit. Market liberals tend to have a strong belief in individual rationality: people can anticipate their own futures better than others, such as the government. Outside the economic sphere, market liberals tend to be strong proponents of equality in areas such as political, legal and civil rights. In the economic sphere, market liberals tend to oppose redistribution for two reasons. One is that they argue that each person has the right to enjoy the fruits of his/her labour; the other is that they are wary of the disincentive effects of transfer programmes."

[12] Eamon O'Shea and Brendan Kennelly, 2004, *Imagining a Future Without poverty and Inequality in Ireland: Do We Want a More Egalitarian Society?*, in 'Spirituality and Poverty in a Land of Plenty', Dublin: Dominican Publications.

They go on to point out that there is a tendency among Irish decision-makers to think of equity issues as secondary to the over-riding pursuit of efficiency. The Department of Finance acts on the basis that its primary role is to control expenditure instead of thinking about social objectives that can only be satisfied through increased expenditure. This approach has major implications for the following two issues we raise in this context i.e. social provision and infrastructure.

- **Social Provision**

This issue has been addressed comprehensively in the first chapter of this book. We accept that analysis in full and, consequently, do not repeat it here.

- **Infrastructure deficits**

Again this issue has been addressed more than adequately in the first chapter of this book. Likewise, we accept that analysis and do not repeat it here. Suffice it to say that the issue of taxation is crucial if there is to be sufficient income available to address the social provision requirements and the infrastructure deficits currently being experienced by Irish society.

- **Sustainability**

Ireland's air is becoming more and more polluted. Between 1990 and 2000 the EPA reveal that Ireland's greenhouse gas emissions grew by 24 per cent. Total combined Irish emissions of the three main greenhouse gases regarded as having global warming potential amounted to 66.3m tonnes of CO2-equivalent in 2000, up from 53.4m tonnes in 1990[13].

[13] Environmental Protection Agency (2002), *Environment in Focus 2002: key environmental indicators for Ireland*, Dublin, EPA, p. 20

These emissions now exceed the limits agreed under the Kyoto protocol. We welcome Ireland's ongoing commitment to this protocol, despite the refusal of the USA to ratify its implementation. However, these emissions are a major cause of climate change, and it is in all our interests to ensure that the limits agreed in the Kyoto protocol are met.

The Irish government and the European Commission agreed a target of an 8 per cent reduction in European CO2 emissions on their 1990 level by 2012. Within this agreement, Ireland agreed to limit its increase of CO2 emissions to 13 per cent between 1990 and 2012. However the latest figures available, for 2001, show that Ireland had increased emissions by 31 per cent since 1990.[14] Major changes are required if we are to reduce our emissions and reach this target. Central to this is the need for full implementation of the National Climate Change Strategy. However, the decision in early 2004 to allow Ireland's 100 largest industrial companies to maintain their current levels of emissions does not assist in progressing towards these aims.

This strategy proposed to impose (unspecified) taxes on oil, gas, coal and other fossil fuels to be phased in from 2002. However, in spite of a few budgetary innovations, there has been limited progress in implementing this proposal. We welcome the commitment in Budget 2003 to the introduction of these taxes and we hope that this commitment is honoured.

[14] Central Statistics Office (2003), Measuring Ireland's Progress (Volumes 1), Dublin, Stationery Office, p. 59.

A Fairer Tax System for the 21st Century

There are several issues that must be addressed if Ireland's tax system is to be fairer going forward in the 21st century than it is today. We highlight four key issues we consider most important if fairness is to be secured in the Irish taxation system. These issues are:

- The level of taxation.
- The tax base.
- The need for simplicity.
- Securing fairness through redistribution.

We consider each of these in turn.

- **Level of taxation**

The key issue at the core of discussions about the appropriate level of taxation is the linking of revenue with investment in the provision of services and infrastructure. At one point in time it might be appropriate to have a particular level of taxation. At another time it might be appropriate to have a slightly higher or lower level of taxation.

This issue has been addressed in the first chapter of this book. We simply point to the fact that Ireland's investment in social provision and infrastructure lagged far behind most EU countries for many years because the resources did not exist to maintain a comparable level of investment. In more recent years the resources have become available as Ireland's GDP/GNP has exceeded the EU average for the first time. Consequently, it is appropriate now to tackle the deficits that have existed for so long. Of its very nature this may well require, for a number of years, a level of investment that is in excess of the EU average. Subsequently, the investment levels required would be likely to be in the region of the EU average if we were to keep pace with EU developments and improving standards.

Those who currently argue for low taxation usually fail to engage with the service provision issue in particular. Instead, they argue that ‘you can forget about tax revenue if you don’t have jobs and you can forget about jobs if you don’t have low taxes’. Very often these same people will acknowledge that one of the major factors that produced the ‘Celtic Tiger’ economy was the level of education of the labour force. But they fail to acknowledge that this education level was the product of very substantial investment over a long period of time.

According to Nobel Economics Laureate Professor Joseph Stiglitz, speaking during a recent trip to Ireland, “all the evidence is that the low tax, low service strategy for attracting investment is short-sighted.”[15] Professor Stiglitz went on to say that: “Far more important in terms of attracting good businesses is the quality of education, infrastructure and services.”

If Ireland insists on presenting itself as a low tax economy so as to attract foreign direct investment it is involving itself in a game where it can be, and probably will be, outbid. Rather, Ireland should be focusing on delivering quality in its education, its services and its infrastructure. Professor Stiglitz, who chaired President Clinton’s Council of Economic Advisors, argues that “low tax was not the critical factor in the Republic’s economic development and it is now becoming an impediment”.

The European Commission has pointed out that the issue of providing adequate resources to fund services must be addressed by the Irish Government. Ireland’s *National Action Plan against Poverty and Social Exclusion, 2003-2005*[16] was published in 2003. It outlines the targets Government intends to achieve in a range of areas dealing with the tackling of poverty and social exclusion. In its joint inclusion report which reviews all the action plans produced by all EU members,

15 In an interview with John McManus, Irish Times, July 2, 2004.

16 Office for Social Inclusion, 2003, *National Action Plan against Poverty and Social Exclusion, 2003-2005*, Dublin.

the European Commission puts it clearly when it states: “The major challenge (for Ireland) will be to ensure that resources are made available to implement the agreed targets.” In other words, according to the Commission, Ireland needs to put its money where its mouth is. Ireland has one of the lowest overall tax takes in the EU, and it shows in our services (particularly for those on low incomes) and in our increasingly divided society. The standard reaction of Government, when confronted with this reality, is to start arguing over figures, presenting numbers that are recognised as irrelevant in every other member country of the EU, while ignoring the indicators it itself has accepted in negotiations with other EU member states.

Ireland’s current level of taxation is substantially lower than it was at the start of the 1990s. In 1990 total taxation was equal to about 40 per cent of GNP. By 2001 it had fallen to 34.5 per cent of GNP.[17] This tax-take is substantially lower than the EU average (41.6 per cent of GDP). Only Portugal had a lower level of tax-take at 34.1 per cent in 2001. This issue has been addressed in the first chapter of this book and in other publications[18] and so it is not necessary to expand on it here.

What is clear is that the present level of taxation (i.e. total tax-take) is not sufficient to provide sufficient investment to address the deficits in social provision and infrastructure. No programme has been set out that shows how these deficits are ever likely to be bridged if the total tax take is maintained at its present level. Consequently, the level of taxation needs to be increased for the present. In due course it may well be the case that the level of taxation should be reduced. But in terms of the principles of justice outline already it is clear that the level of taxation should be sufficient to address the deficits we have identified here. Only then can we hope to see these deficits reduced and, eventually, removed and in this way ensure the basics of a just

[17] NESC, 2003, pp. 291 ff. The calculations are based on the OECD definition of taxation and include social security taxes and the tax receipts of local government.

[18] For example, cf. CORI Justice Commission, 2004, *Priorities for Fairness*.

society are put in place in Ireland in the years immediately ahead. This leads us to our second key issue which is the tax base. The level of taxation needs to increase. Consequently, what should the tax base, from which it is drawn, be?

- **Tax Base**

There are several problems in the Irish tax system when to look at the tax base. One of the major problems concerns the lack of neutrality within the system itself. In his recently published book, Professor John Bristow summarises this problem eloquently as follows:

> "There is discrimination among different source of income under the income and corporation taxes; between receipts taxable as capital gains and those taxable as income; among different uses of income, as manifest in selective deductions for saving and non-business expenses; among different types of wealth transfer; and among consumption items under the value-added tax and excises."[19]

- **Tax expenditures**

The tax system incorporates a sizeable number of tax expenditures, primarily in the form of tax reliefs[20]. The scale and distribution of these expenditures is of interest.

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[19] John Bristow, 2004, *Taxation in Ireland: An economist's perspectiv*e, Dublin: IPA, p. 115.

[20] This analysis is drawn, principally, from *Sustaining Progress*, CORI Justice Commission's annual Socio-Economic Review for 2004.

Table 1 outlines some of the major income tax expenditures and the cost of providing them per annum. The cost of these schemes is calculated in the amount of tax revenue foregone (i.e. not collected). A recent Eurostat report [21] draws attention to the fact that the Department of Finance is unable to provide details and costs for some of the tax expenditure schemes. It explains that this is due to the fact that some of the reliefs are provided without any requirement for formal reporting (stallion stud fees etc).

Table 1: The annual cost of income tax allowances and relief's.

	No's availing	Cost in €m's
Capital allowances	n/a	1649
Exemption of Pension Fund Income	n/a	1274
SSIA scheme	1,170,200	525
Employers Pension Contributions	n/a	645
Employees Pension Contributions	n/a	456
Resort Relief	n/a	106
Mortgage Interest Relief	462,000	205
Self Employment Pension Contributions	104,500	170
Medical Insurance Relief	533,000	160
Employee Expenses	856,900	61
Artists Relief	941	30

Source: NESC, 2003:341-342.
Note: The figures provided are mainly for the tax year's 1999/00 and 2000/01.

21 Eurostat (2003), *Structures of the Taxation System in the European Union*, Luxembourg.

The annual cost of income tax allowances and reliefs is very substantial. A table carried in the NESC strategy report of 2003[22] estimates the annual cost of the major income tax allowances and reliefs to be in excess of €5.2 billion (mainly calculated on the figures for 1999/2000 and 2000/2001 and excluding tax relief on Child Benefit). If these reliefs did not exist the annual tax-take would be this amount larger than it is. Given that the net revenue from income tax for 2004[23] has been estimated by Government to be €10 billion, we can see how big an impact these reliefs and allowances have.

The distribution of these tax expenditures is primarily in the direction of the better off elements of Irish society. To take one example, the NESC recently examined which households in the income distribution gained as a result of tax relief on employee's occupational pensions during 1998.[24] The results are presented in table 2 and show that the bottom 20 per cent of households received zero per cent while the top twenty per cent of households receive 56.8 per cent of the relief. Overall the distribution of the tax relief is heavily skewed towards the top forty per cent of households who receive almost 89 per cent of the value of this scheme.

[22] NESC, 2003, pp. 341-342.
[23] Department of Finance, December 2003, *Budget 2004*, p. D.6.
[24] NESC 2003, p. 301.

Table 2: The distribution of employees' occupational pension tax relief across households in the income distribution, 1998.

Decile	% of total tax relief
Bottom	0.0
2nd	0.0
3rd	0.3
4th	1.6
5th	2.7
6th	6.4
7th	13.8
8th	18.3
9th	20.8
Top	36.0
Total	100.0

Source: NESC, 2003:301.

The suggestion that it is the better off who principally gain from the provision of tax exemption schemes is underscored by a report published by the Revenue Commissioners in 2002 entitled *Effective Tax Rates for High Earning Individuals*. This report provided details of the Revenue's assessment of the top 400 earners in Ireland and the rates of effective taxation they faced [25]. Table 3 presents their findings and shows that many of Ireland's highest earning individuals successfully use tax planning, schemes and loopholes to reduce their tax liability. The study found that property tax reliefs, such as those provided for hotels and car parks, were the most effective in reducing the tax rates of the highest earners.

[25] The effective taxation rate is calculated as the percentage of an individual's total pre-tax income that they pay in taxation.

Table 3: The Distribution of Effective Tax Rates of the Top 400 Earners, 1999/00

Effective Tax Rate	**% of Total**
Less than 15%	18.0
15%-29%	11.2
30%-44%	57.8
45% +	13.0
Total	**100.00**

Source: Revenue Commissioners (2002).

We believe that many of these reliefs serve minimal purpose. Consequently it is apparent that all these reliefs should now be reviewed via an assessment of the economic and social benefits that they provide. Only where these benefits surpass the costs should the reliefs be retained. Furthermore we believe that any proposed reliefs should be assessed in similar format before being introduced in the future.

We also believe that there is a very strong case for introducing a minimum effective tax rate for both income and corporation taxes that should apply to all income above a modest threshold. This would ensure that no further mechanisms were designed to enable those who are better off to escape paying a fair level of taxation. Otherwise the basic principles we have discussed already would not be honoured.

- **Corporate taxes**

Moving on to the corporate sector the major development in recent years has been the spectacular reduction of the corporation tax rate to 12.5 per cent. There is no evidence to support the argument that the corporate tax rate needs to be this low. If there is evidence to support this rate then it should be published and be available to those involved in policy development. On the other hand if the rate need not be that low then all we have done is transfer Irish tax-payers money to the corporate sector.

The recently-published Enterprise Strategy Group Report[26] throws two interesting lights on this issue. In the first place it provides no evidence in favour of the 12.5 per cent rate being the correct one. But it *asserts* that a continuing low tax regime is required because this is the trend globally. The report's second item of note in this context is its focus on effective rates, showing that the effective tax rates differ from headline rates across the EU. It appears to us that there is much to recommend an approach that would focus on securing a minimum effective corporate tax rate for the EU as a whole. Otherwise we fail to see how the rate will not be at zero per cent in a relatively short time.

But the low corporate tax rate is far from being the whole story. There are no reliable figures to estimate the cost of tax reliefs that can be applied to business income. The depreciation process is a mechanism through which business receives significant tax relief. There is no estimate available to the public of the cost of the accelerated depreciation granted to certain types of construction. This form of depreciation has been granted to a wide range of schemes including car parks, tourist accommodation, town centres, etc, yet there is no evidence that these concessions provide any benefit to anyone other than those who are able to avail of the concessions. There is no evidence to show that the local development would not have occurred in the absence of such concessions. These concessions are really subsidies to developers with no real gain to the wider society. Even if there was a gain to the wider society there is an additional question such as why would we want more car parks in Ireland than market forces can produce?

26 Department of Enterprise, Trade and Employment, 2004, *Ahead of the Curve: Ireland's Place in the Global Economy*, Enterprise Strategy Group Report.

In a similar way to income tax reliefs we believe that corporate tax reliefs serve minimal purpose. Consequently it is apparent that all these reliefs should now be reviewed via an assessment of the economic and social benefits that they provide. The reliefs should be retained for the corporate sector only where these benefits surpass the costs. Furthermore we believe that any proposed reliefs should be assessed in similar format before being introduced in the future.

- **Site Value Tax**

Taxes on wealth are minimal in Ireland. We are the exception to the rule among developed countries in having no residential property tax. Revenue is negligible from capital acquisitions tax because it has a very high threshold where bequests and gifts within families are concerned and it treats family farms and firms very generously.

Where residential property tax is concerned we are convinced that the introduction of an annual site value tax would have a very positive impact on Ireland's tax situation. It would lead to a substantial broadening of the base at a single stroke and would also lead to a reduction of the tax-take required from other sources, thus providing an opportunity for Government to produce a just and fair tax system.

An annual site value tax is a recurring tax on the land or location value of property. This is different from a conventional property tax. A conventional property tax would levy tax on land value and buildings. A site value tax is a property tax that applies only to the land value part of the property.

A site value tax is positive on both efficiency and equity grounds. From an efficiency perspective a site value tax would be a major step toward securing the tax base as it could not move to any location providing greater tax reductions. In doing this it would move the tax away from a transaction (such as stamp duty) which can make the tax base vulnerable as it is dependent on maintaining and increasing the scale of the transactions and move it instead to an immovable physical asset which is a much securer base. It would have other efficiency impacts such as ensuring that derelict sites were developed and that land would not be held over, as appears to be the situation at present, in an attempt to increase its value by creating artificial scarcity of land for development.

A site value tax is also positive on equity grounds. High land values in urban areas of Ireland are mainly a product of the economic and social activity in those areas. Consequently, it can be argued that a substantial portion of the benefits of these land values should be enjoyed by all the members of the community and not just the site owners. As well as this the increasing site values are closely linked to the level of investment in infrastructure those areas have received. Much of that investment has been paid for by taxpayers. It can be argued that a substantial portion of the benefits of the increasing site value should go to the whole community through the taxation system and not just remain with the site owner who may well have made no contribution to the investment that produced the increased value.

- **Carbon tax**

As we have noted already the issue of sustainability is now a major issue. The finite nature of our environment demands that we take account of environmental costs along with other factor costs. Measures to protect the environment have necessarily involved intervention in the market, because market forces do not themselves provide for environmental protection. Up to now this 'intervention' has been by legislated regulatory measures.

In the long run, however, a more comprehensive approach is required. In recent years the sheer increase in the volume of economic activities has often negated regulatory gains. A key step would be to include in prices – and thereby internalise – the environmental costs occasioned by economic activity. It is difficult to devise any methodology capable of tracing and attributing with any accuracy all the costs/damage wrought upon the environment by a particular activity. Thus in many cases the internalisation can be achieved only in an arbitrary way, i.e. by taxes/charges based on broad national assessment.

The success of the plastic bag tax in reducing consumption of bags by 95 per cent in its first year, while simultaneously raising €11m for environmental projects, highlights the benefits of these types of taxes.

The Budget of 2003 contained a commitment by government to impose carbon taxes The all-party Oireachtas Committee on the Environment has supported this. The National Climate Change Strategy contains a commitment to introduce carbon taxes. Likewise, the recently published report of the Enterprise Strategy Group also supports the introduction of a carbon tax.[27]

The Government's recent decision not to proceed with the proposed introduction of carbon taxes was a mistake in that it again postpones action in this crucial area.

One of the objections presented to the introduction of these taxes is that they will substantially damage the economic position of poor households. Indeed research by the ESRI has confirmed this. However, a series of research papers by the ESRI has shown that it is possible to insulate poorer households from the effects of these new taxes (see Bergin et al (2002:25), Scott and Eakins, 2002). Scott and Eakins have suggested that a proportion of the revenue generated by these new taxes should be transferred to the Department of Social and Family Affairs and used by them to increase payments (in particular fuel allowances) given to poor households. Such an increase in these payments would therefore compensate poorer households for the effect of the new tax and consequently ensure that Ireland's poorest households do not suffer.

If the government decision not to introduce a carbon tax is to be implemented then serious consideration should be given to the proposals made by Richard Douthwaite in his chapter in this book. Such an approach would go a long way towards developing the more comprehensive approach that we have advocated in this area.

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[27] Department of Enterprise, Trade and Employment, 2004, *Ahead of the Curve: Ireland's Place in the Global Economy*, Enterprise Strategy Group Report, p. 84.

- **Keep it simple**

Our tax system is not simple. John Bristow argues that “some features of it, notably VAT, are among the most complex in the world”[28]. The reasons given to support this complexity vary but they are focused principally around the need to reward particular kinds of behaviour which is seen as desirable by legislators. This, in effect, is discrimination in favour of one kind of activity or against another. There are many arguments against the present complexity and in favour of a simpler system.

Discriminatory tax concessions in favour of particular positions are often very inequitable. They often contribute far less to equity than might appear to be the case. On many occasions they fail to produce the economic or social outcomes which were being sought. Sometimes they generate very undesirable effects. At other times they may be a complete waste of money since the outcomes they seek would have occurred without the introduction of a tax incentive.

Having a complex system also has other down-sides. It can, for example, have high compliance costs both for tax-payers and for the Revenue Commissioners who are responsible for collecting tax.

A simple example may serve to illustrate the issues involved. A simple income tax system would treat all income to a taxpayer in the same way irrespective of the source of the income or of what the tax-payer does with the income. But that is far from the present situation. A wage increase may be taxed at 42 per cent but income from bank interest or from capital gains will be taxed at 20 per cent. If a person chooses to contribute directly to his/her pension fund the money will not be taxed.

[28] Irish Times, June 25 2004,Business This Week, p. 5

Each of these features gives more benefit to the better off because interest receipts, capital gains and pension contributions all rise as total income rises. Why, for example, should the tax system favour the development of additional private pensions for the better off? Why are tax-payers as a whole forced to subsidise these people? Those who want to have more pension income would, more than likely, make provision for having such additional income even if there was no tax concession attached. This is simply a subsidy to the better off, paid for, in part at least, by those who are poorer.

A further example serves to illustrate the problematic nature of using the tax system to offer incentives to support particular kinds of activity. There have been many initiatives offering favourable tax treatment to investments in town centres, seaside holiday homes, private clinics, car parks and other items. Those who benefit from these initiatives are the investors and only the investors. These investments offer little or no benefit to society. If they would not be undertaken without tax incentives we would probably be better off without them.

VAT provides an example of an unnecessarily complex part of the system. Many countries zero-rate only exports, exempt almost nothing and apply a single VAT rate to everything else. This makes the collection of VAT very simple. However, in Ireland we zero-rate food and children's clothing. Of the 120 countries that have a VAT system only the UK joins us in this approach to zero-rating. Some of the distinctions that have to be applied by supermarkets for example are most amusing. Digestive biscuits pay one rate but chocolate digestive biscuits pay a different rate. Circuses and fairgrounds pay different rates. The different rates are justified under a claim that they contribute to equity. But this contribution is very questionable. A single rate of 14 per cent giving the same revenue as at present, combined with small changes in income tax and social welfare benefits (to offset the loss to those with low incomes) would be a far fairer system.

For the most part society at large gains little or nothing from the discrimination contained in the tax system. In some cases this discrimination causes very negative effects. Mortgage interest relief, for example, and the absence of any residential or land-rent tax have contributed to the rise in house prices.

The failure to apply Direct Interest Retention Tax to non-resident as well as resident accounts led to the DIRT scandal. Most of the illegal tax evasion identified in recent years in Ireland has arisen because of the opportunities for evasion that have been provided by a too-complex system.

Complexity makes taxes easier to evade, invites consultants to devise avoidance schemes and greatly increases the cost of collection. It is also inequitable because those who can afford professional advice are in a far better position to take advantage of that complexity than those who cannot afford to do this. Having a complex tax system adds no economic or

- **Securing fairness in the tax system**

The need for fairness in the tax system was clearly recognised in the first report of the Commission on Taxation more than twenty years ago. In that volume it stated

> "…in our recommendations the spirit of equity is the first and most important consideration. Departures from equity must be clearly justified by reference to the needs of economic development or to avoid imposing unreasonable compliance costs on individuals or high administrative costs on the Revenue Commissioners."[29]

The need for fairness is very obvious today. All the issues already raised in this section of the paper have a fairness dimension. Here we address some of the further issues that arise particularly in the present income tax system.

[29] Report of the Commission on Taxation, 1982, volume 1, p. 29.

- **Increasing tax credits rather than widening tax band**

When money is available to fund tax cuts, choices have to be made. Should the money be used to expand the tax band or increase the tax credit? To illustrate the impact of these options we can take an example. If €700 million were available for distribution in the forthcoming Budget (2005) it could be used to:

- Increase the 20 per cent tax band by €5,500 or
- Increase tax credits by €512 a year.

What impact would these changes have?

- Increasing the tax band by €5,500 would be of no benefit to anyone with incomes at or below the top of the current band (i.e. €28,000 for a single person) but would provide a benefit of €1,210 a year to a single person earning more than €33,500. Single people with incomes in the €28-33,000 range would benefit by a proportion of the €1,210. (The thresholds for married people with one or two incomes are different but the impacts are along the same trajectory as identified for single people here.)

- Increasing the tax credit by €512 a year would mean that every earner with a tax bill in excess of €512 a year would benefit by that amount. (Those with lower tax bills than this create a different issue and are addressed later in our section on refundable tax credits.)

So in terms of fairness increasing tax credits is a fairer option than widening the standard rate tax band. Government should take this option when it has money available to reduce income taxes. It has the additional advantage of addressing the ‘working poor’ issue which is emerging as a growing problem that requires a policy response (cf. below).

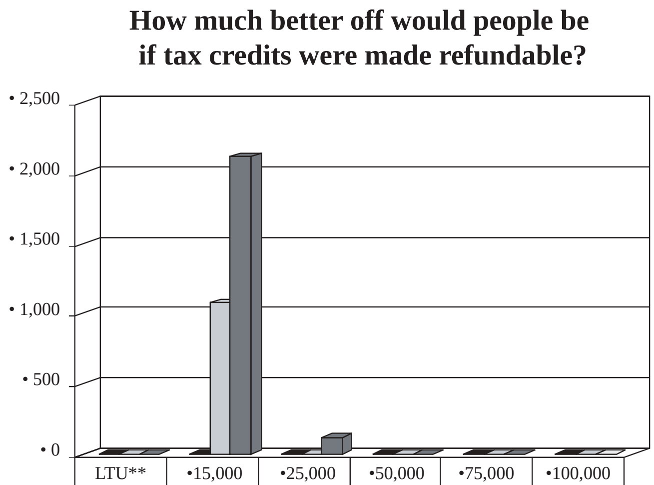
- **Making tax credits refundable**

A second issue arises concerning those on very low incomes. The move from tax allowances to tax credits was completed in Budget 2001. This was a very welcome change because it put in place a system that had been advocated for a long time by a range of groups and individuals including the present authors. One problem persists however, a problem that the old system of tax allowances also had. If a person does not earn enough to use up his or her full tax credit then he or she will not benefit from any tax reductions introduced by government in its annual budget. In effect this means that, under the present system, those with the lowest pay will not benefit in any way at budget time.

A simple solution exists to rectify this problem: make tax credits refundable. This would mean that the part of the tax credit that an employee did not benefit from would be “refunded” to him/her by the state. A Social Partnership Working Group has examined the feasibility of making this happen but has not completed its report.

The major advantage of making tax credits refundable would lie in addressing the disincentives currently associated with low-paid employment. The main beneficiaries of refundable tax credits would be low-paid employees (full-time and part-time). Chart 1 displays the impacts of the introduction of this policy across the various gross income levels. It clearly shows that all of the benefits from introducing this policy would go directly to those on the lowest incomes. Anomalies that would arise concerning those working for only a few hours or those who are retired would have to be addressed to ensure that this proposal did not lead to substantial expenditure that did not go to the target group i.e. those in very low-paid jobs.

Chart 1:



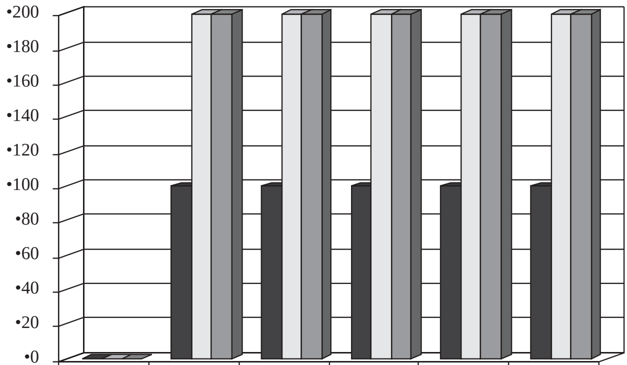
	LTU**	•15,000	•25,000	•50,000	•75,000	•100,000
■ Single	0	0	0	0	0	0
□ Couple 1 Earner*	0	1080	0	0	0	0
■ Couple 2 Earners*	0	2120	120	0	0	0

Notes: * Except in LTU case where there is no earner
** LTU: Long Term Unemployed

Following the introduction of refundable tax credits, all subsequent increases in the level of the tax credit would be of equal value to all employees. Chart 2 shows how the benefits of a €100 a year increase in tax credits would be distributed under a system of refundable tax credits. This simulation displays the equity attached to using the tax-credit instrument to distribute budgetary taxation changes. The benefit to all categories of income earners (single/couple, one-earner/couple, two-earners) is the same. Consequently, in relative terms, those earners at the bottom of the distribution do best.

Chart 2:

How much better off would people be if tax credits were increased by €100 per person and this was refundable?



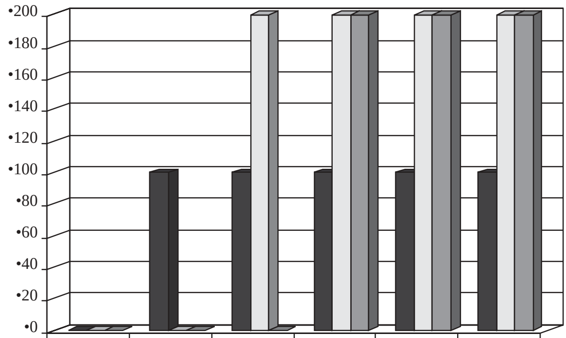
	LTU**	•15,000	•25,000	•50,000	•75,000	•100,000
Single	0	100	100	100	100	100
Couple 1 Earner*	0	200	200	200	200	200
Couple 2 Earners*	0	200	200	200	200	200

Notes: * Except in LTU case where there is no earner
** LTU: Long Term Unemployed

The benefits of adopting a refundable tax credits system is further underscored by a comparison between chart 2 and chart 3. Chart 3 shows the allocation of gains across all categories of earners. It shows that the benefit of the gains allocates all resources equally to all categories of earners above €25,000. However, there is no benefit for these workers whose earnings are not in the tax net.

Chart 3:

How much better off would people be if tax credits were increased by €100 per person?



	LTU**	•15,000	•25,000	•50,000	•75,000	•100,000
Single	0	100	100	100	100	100
Couple 1 Earner*	0	0	0	0	0	0
Couple 2 Earners*	0	0	0	0	0	0

Notes: * Except in LTU case where there is no earner

** LTU: Long Term Unemployed

In a Dail reply the former Minister for Finance indicated that the cost of making basic personal and PAYE credits refundable would be in the region of €1.3 billion in a full year (April 8 th, 2003). This calculation is for a proposal being made by no individual or group that we know of. If the anomalies we already referred to are addressed we believe that the cost would range between a quarter and a third of the former Minister's costing.

If the tax system is to be fair then tax credits should be made refundable.

- **Addressing the 'working poor' issue**

18.8 per cent of all those at risk of poverty live in households headed by an employee. A further 6.6 per cent live in households headed by a self-employed person. So we currently have a situation where over a quarter of those at risk of poverty live in households headed by a person who is in paid employment. This issue must be addressed. The most effective way of targeting this group is to implement the two preceding proposals identified here i.e. use the money available for tax reductions to increase tax credits and make these tax credits refundable.

Summary of Proposals

Increase the level of taxation

- Increase the overall level of the tax-take to secure sufficient income to tackle both the infrastructure and social provision deficits currently being experienced.

Broaden the tax base

- Assess the economic and social benefits of current tax expenditures and only where these surpass the costs should the reliefs be retained.
- Introduce a minimum effective tax rate for both income and corporation taxes.
- Secure a minimum effective corporate tax rate for the EU as a whole.
- Review all corporate tax reliefs and retain only those whose benefits exceed their cost.
- Review all future proposals to reduce the tax base along similar lines.
- Introduce an annual site value tax. Much of the tax-take from this source would be used to reduce the tax take from other sources in a fair and equitable manner.

- Introduce a carbon tax ***or*** move towards a tradable quotas system as an effective way of addressing the environmental sustainability issues that currently face Ireland.
- Increase the rate for capital gains tax (CGT)

Keep it simple

- Ensure all income to a taxpayer is taxed in the same way irrespective of the source of the income or what the tax-payer does with the income.
- Remove all aspects of the tax code that, in effect, provide a subsidy to the better off.
- Introduce a single VAT rate (a rate of about 14 per cent would bring in the same total tax-take from this source as at present), zero-rate only exports and compensate those on low incomes for their losses in this transition.
- Apply DIRT to non-resident as well as resident accounts.

Secure fairness in the tax system

- Increase tax credits rather than widening the tax band
- Make tax credits refundable
- Tackle the 'working poor' issue by introducing the two preceding initiatives.