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IRELAND

SELECTED ISSUES

July 2022

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INTERNATIONAL MONETARY FUND

IRELAND

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June 16, 2022

Approved By
European Department

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ENSURING AN INCLUSIVE AND GROWTH-ENHANCING FISCAL POLICY MIX[1]

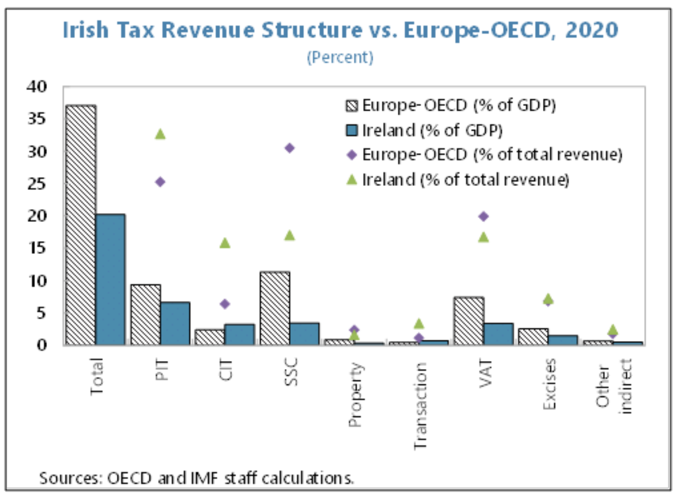
A. Context

1. **Ireland revenue intake has been strong in recent years, but its tax base remains narrow and reliance on income taxes has increased fiscal vulnerabilities.** In particular, increased reliance on potentially volatile and highly concentrated corporate income tax (CIT) revenues on the one hand, and growing expenditure pressures on the other present a challenge to the sustainability of public finances and requires preemptive reforms to broaden the tax base, reduce tax expenditures, and raise the efficiency of public spending. Furthermore, long-term demographic trends highlight the need for reforms to safeguard the sustainability of the pension system.

2. **This paper reviews Ireland's challenges and reforms needed to meet the above challenges.** It assesses the scope for improving the tax system towards a more growth-friendly structure, and for achieving efficiency gains in public expenditure. It also discusses upcoming impediments to long term fiscal sustainability and proposes. options to achieve a more growth-friendly and equity-enhancing revenue and expenditure policy mix.

B. Revenue Composition

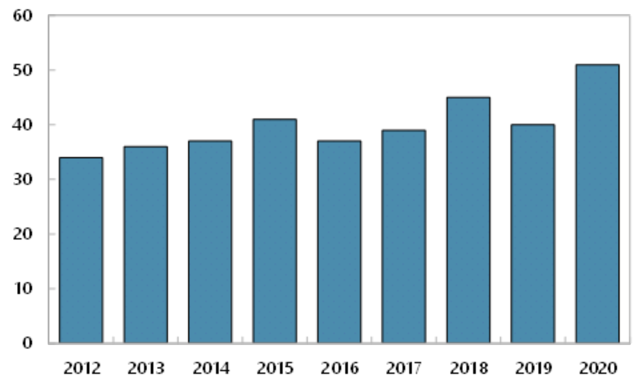
3. **Ireland's ratio of tax revenues to GDP is the lowest in the EU.** Even when measured against the much smaller GNI*, it is still below the EU average. In addition, its reliance on income taxes is significantly larger than the OECD-Europe average, especially regarding personal income tax (PIT), which accounts for about 30 percent of total tax revenue. And while progressive, with large share of the workforce exempt from paying income tax, a large burden falls on the rest of taxpayers, as very high marginal tax rates apply at relatively low levels of income. Furthermore, despite having one of the lowest statutory CIT rates in Europe, the share of CIT taxes in total revenue is much larger than the EU average. Building a more resilient revenue structure is, therefore, needed to ensure stable revenue sources. With an already high PIT burden, the challenge will be on broadening the tax base.



[1] Prepared by Karina Garcia.

4. New international taxation rules could have an impact on future CIT revenues.[2] CIT revenues have increased over the past years, reaching an all-time high close to 3.5 percent of GDP in 2021 and becoming the third-largest source of government income. It is also highly concentrated, with over half being paid by the top ten taxpayers, many of which are affiliates of U.S. multi-national enterprises (MNEs). The prospective changes in international CIT rules, will likely apply to the large MNEs and only a very small number of big domestic Irish companies, mainly in the retail and utilities sectors. The authorities estimate the new rules could cost roughly 2 billion euros (or about half a percent of GDP) in lost revenue annually. However, there are uncertainties around the future impact related to ratification by the different countries and finalizing the details for a common framework for the reallocation of revenues.

Concentration of CIT Receipts
(Percent net receipts by top 10 companies)



Source: Fiscal Council.

C. Growing Expenditure needs and Long-Term Spending Pressures

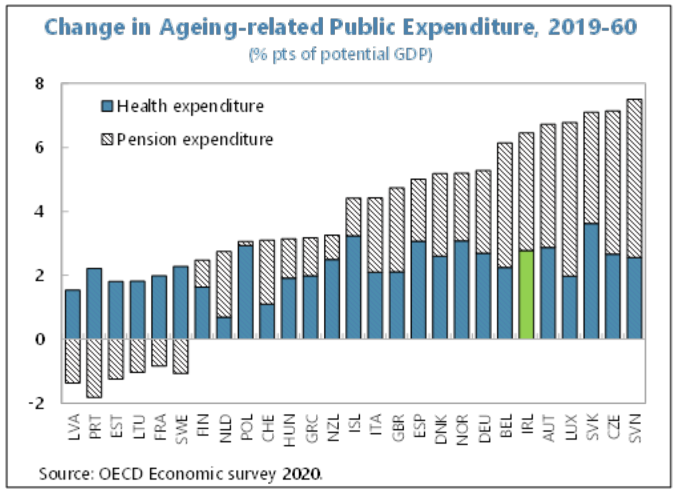
5. Ireland faces growing expenditure needs to facilitate the transformation to a more inclusive growth. Higher spending on infrastructure, housing, social protection, green transition, as well as education, training, and active labor market policies are needed to help the green and digital transformation of the economy and support the reallocation of labor to the growing sectors. Furthermore, well-designed, and targeted public spending would help increase the productivity of the indigenous sectors, particularly for SMEs, and deepen the inward linkages of MNEs, thus broadening the benefits for growth to a wider portion of the population. While Ireland has stepped up public investment in recent years, including in infrastructure, further increases will be needed to compensate for the post-global financial crisis (GFC) underinvestment and to address the new challenges from the ambitious climate action commitments and the digital transformation of the economy.

6. Under the 2021 National Development Plan (NDP), the government plans to significantly expand investment to historically high levels over the medium term. The NDP envisions maintaining public investment at approximately 5 percent of GNI* through 2030, and a total allocation of €165 billion, focusing on supporting housing, climate goals, transportation,

[2] The new rules are based on a two-pillar framework. Aiming for a fairer distribution of profits and taxing rights, Pillar I proposes a reallocation of some taxing rights over large MNEs from their home countries to the markets where they have business activities and earn profits, regardless of physical presence. Under pillar II, a minimum effective corporate tax rate of 15 percent will apply to multinationals with a turnover in excess of €750 million. The new rules are not likely to come into force before 2024.

healthcare, and jobs growth.[3] It is estimated that, by the end of the decade, the investment plan could boost growth by about one percentage point.[4] Efficient and well-targeted investment strategies will be key to maximize the impact on long-term growth and prevent capacity utilization bottlenecks, thus securing high value for the taxpayers.

7. Demographic trends will also put pressure on long-term public finances. Ageing-related spending is expected to increase considerably over the next decades even compared to peer countries. Without broadening the tax base, this could imply difficult spending trade-offs and contribute to fiscal vulnerabilities. Timely reforms to contain ageing-related budget expenditure and improving spending efficiency will reduce vulnerabilities and ensure adequate funding for the NDP's ambitious investment agenda. Furthermore, long-term expenditure pressures will require increased spending on health, social protection, and pensions over the coming years, therefore, improving public expenditure efficiency particularly in these areas is a priority.



8. Good progress has been achieved in raising public spending efficiency but there is scope for further improvement. The 2017 IMF's Public Investment Management Assessment (PIMA) identified the need to strengthen adherence to budgeted targets and to enhance the implementation of infrastructure projects and maintenance of public assets. Significant progress has been achieved in planning, allocation and monitoring of projects through the establishment of the National Investment Office. The introduction of annual spending reviews has also been helpful in reallocating resources within current expenditures, and the introduction of the investment project tracker has been instrumental in enhancing transparency and monitoring expenditures. However, deeper sectoral analyses and further progress to improve the process of project selection and management are needed. Progress in the context of the Spending Review and Performance Budgeting processes is also welcomed.[5] Further effort should be made to systematically collect information on the performance of existing public assets across sectors to better enable transparent, evidence-based prioritization of future infrastructure projects.[6]

[3] National Development Plan 2021-2030.

[4] "Ireland's Next Ramp-up of Public Investment". Irish Fiscal Advisory Council (IFAC) 2021.

[5] IMF Country Report No 16/257.

[6] OECD. Ireland Economic Review. 2020.

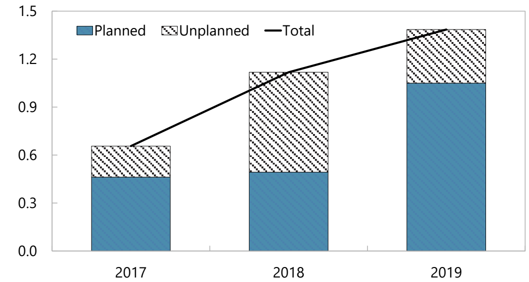
Table 1. Ireland: Implementation of 2017 PIMA Recommendations	
Progress Achieved	**More Progress needed**
Planning. Establishment of the National Investment Office. Integration of major infrastructure projects in with one single national strategy (National Development Plan). Maintenance of public assets.	Strengthening adherence to budgeted targets in certain sectors. Systematically collect information on the performance of existing public assets across sectors.
Allocation and Monitoring. Introduction of a capital tracker to monitor major investment projects. Improvements in risk assessments Improving data collection and identifying data gaps. Implementation of a cost validation system for large projects prior to approval. Introduction of post project implementation reviews.	Further build on the capital tacker to make it more useful across sectors and allow for timely advice.

9. **Healthcare spending has increased significantly over the past years and, at 20 percent of total public expenditure, is the highest in the EU.** A significant portion of this increase has been unplanned, with pre-pandemic health spending accounting for 56 percent of total overruns.[7] While much of the increased spending is due to the pandemic, there was already a history of spending over runs. Most of the overspending is run by hospitals, largely going towards wages. Furthermore, limited community care capacity and a complex system of collaboration between private practices and public hospitals have contributed to long waiting lines in the public system and to cost inefficiencies. With a significant commitment to healthcare reform under the Sláintecare to date and over the next few years, addressing these challenges will be key to deliver the intended output and safeguard the limited fiscal resources.

[7] "The path for Ireland's health budget". IFAC, 2021.

Increases in General Government Healthcare Spending

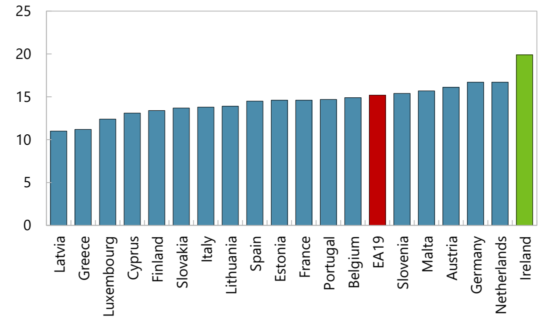
(Billion euros)



Sources: Department of Finance and Fiscal Council calculations.
Note: Data shown in Exchequer gross voted current spending terms. 2019 is an estimate.

General Government Health Expenditure

(Percentage of total general government expenditure, 2020)

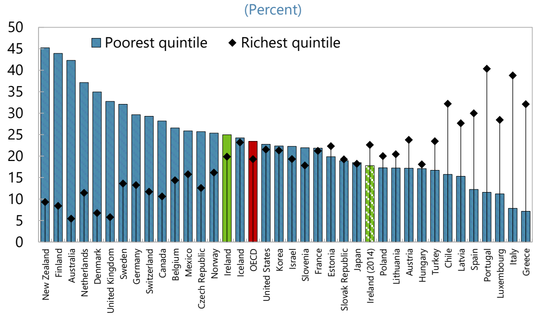


Source: Eurostat.

10. Social protection spending in Ireland is effective overall, but there is scope to increase its efficiency. There is an already high achievement regarding the intended strong redistributive impact of social spending[8] and targeting of measures has improved. However, measures of income poverty and material deprivation point to consistent high incidence of low living standards among lone parents, their children, and those of working age in households without anyone in paid work. The relative poverty rate shows a varied degree of success across age and household status groups. In particular child poverty rate has declined at a much slower pace and has been higher than the EU average during 2017-19.[9] Efficiency of social protection spending can be increased by improving the coverage and targeting of existing programs to the most vulnerable groups and further reducing transfers to high income households.

Share of Public Cash Transfers Received by Working-age Individuals in Low and High-income Groups, in 2016

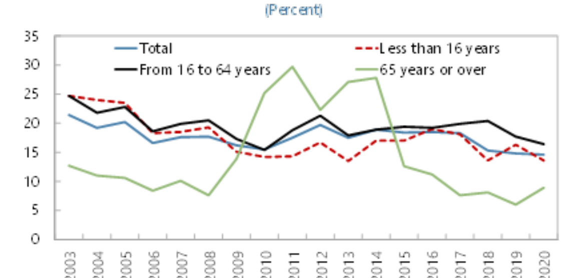
(Percent)



Source: OECD.

At risk-of-poverty Rate Gap by Age Groups

(Percent)



Source: Eurostat.
Note: The relative median at-risk-of-poverty rate gap is calculated as the difference between the median equivalised disposable income of people below the at-risk-of-poverty threshold and the at-risk-of-poverty threshold, expressed as a percentage of the at-risk-of-poverty threshold (cut-off point: 60% of median equivalised income).

[8] International Monetary Fund, 2016 a.

[9] European Commission. Ireland 2022 Commission Report.

D. Towards an Inclusive and Growth-Enhancing Policy Mix

11. The stylized facts presented above highlight the need for reforms to broaden the tax base and find new and stable sources of revenues as well as improving public expenditure efficiency. A narrow tax base and increased reliance on relatively uncertain CIT revenues can limit budget flexibility. Most of the CIT revenue overperformance has been allocated to permanent expenditure measures or funding budgetary overruns. Spending overruns have been particularly large in health and in the implementation of the few large public investment projects.[10] With limited revenue flexibility, future cost overruns could crowd out spending priorities and derail efforts to reduce public debt. The fiscal policy mix should, therefore, aim to secure stable resources to finance the authorities' investment strategy as well as the social and aging-related expenditure needs.

12. A broad and stable revenue base is needed to mitigate vulnerabilities and support priority expenditures. Several reforms can be implemented to expand and diversify tax revenue:

> **a. There is scope to improve the PIT system and reduce administrative costs.** As previously recommended by staff, an introduction of one or two additional tax bands and rates to the PIT would help broaden the tax base and reduce disincentives to work, while preserving the simplicity and progressiveness of the system.[11] When combined with means-tested cash transfers for low-income households, it would ensure a more robust, incentive compatible, and equitable tax system. Furthermore, recalibrating the income tax system by absorbing the Universal Social Charge (USC) could help reduce administrative costs.[12]
>
> **b. Efficiency gains can be achieved by simplifying the VAT system.** Ireland's VAT system includes 5 tier rates, which could render the system complex and prone to significant VAT tax expenditures. Compared to other OECD-European countries, Ireland has a relatively low VAT revenue ratio (VRR)[13], implying that an important share of potential VAT revenues can be collected. Furthermore, while the estimated VAT gap for Ireland is low in comparison to peers, it is still significant. Streamlining the system and improving tax administration could, therefore, yield revenue benefits and reduce VAT tax expenditures. Any negative impact on low-income households can be mitigated by means-tested income support measures.

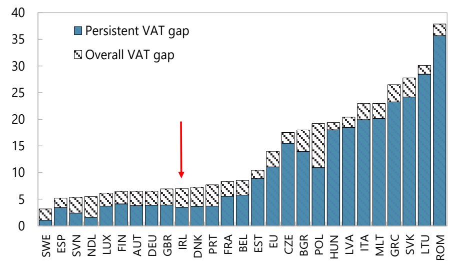
[10] Fiscal Council. Fiscal Assessment Report, November 2019; and IMF Country Report No. 18/194

[11] The Income Tax is levied on total income, according to four social circumstances (marital and family status) and taxed in two bands (20 percent and 40 percent).

[12] See IMF Country Report No 19/165.

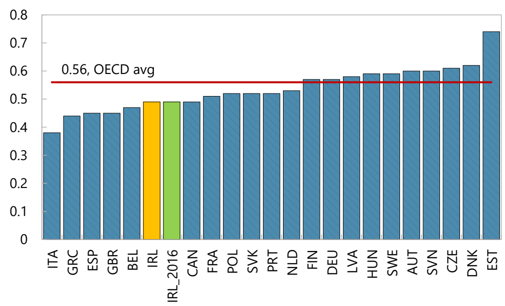
[13] The VRR is the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption.

VAT Gap
(Percent)



Sources: Nerudova and Dobranschi, 2019.
Notes: The VAT gap is the difference between the expected VAT revenue and the amount collected and measures the effectiveness of tax compliance measures.

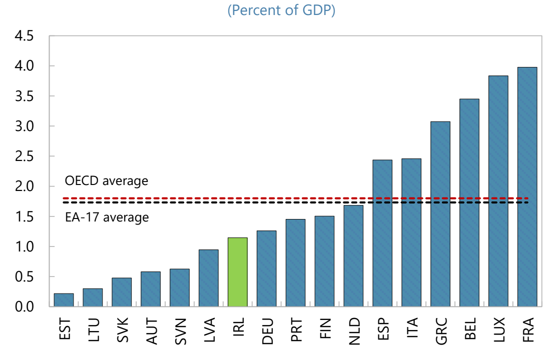
VAT Revenue Ratio
(Percent, 2018)



Source: OECD.

c. **Raising property taxes from their current low level would be a growth-friendly and efficient option.** Ireland's intake from property taxes is substantially smaller than EU peers. Property tax rates remained largely unchanged since 2013 and the revaluation of homes has been infrequent. As the tax was based on 2013 values, all homes bought since 2013 by first-time buyers and newly built homes were excluded until the reform of the system in 2021. This reform constituted a welcome step in modernizing the system and broadening its base. Under the new rules, properties would undergo updated valuations every four years, and houses not previously included in the taxation system will now be covered. Further reforms should aim to gradually increase the tax rate itself from its low level while ensuring adequate social protection.

Tax on Property, 2020
(Percent of GDP)

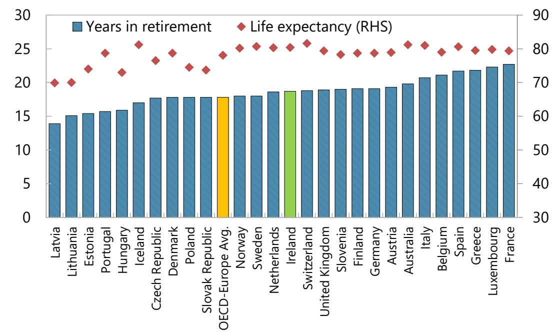


Source: OECD.

13. **Public spending should focus on growth-friendly spending and reducing efficiency gaps.** Investing in health, education, and social protection can help increase human capital and labor productivity, reduce disparities, and strengthen MNEs' inward linkages, while investing in physical capital can have a large impact on improving regional equity and future growth. Public resources can be more effectively used by improving the targeting of social programs to vulnerable groups. Strengthening budget planning and controls would bring credibility and transparency to the health budget and help reduce the incidence of unplanned spending. Following up on recommendations for the health sector's Accountability Framework should also be followed through. Well-targeted, efficient investment will be key to maximize public investment returns. Therefore, the authorities should continue to make progress on the remaining steps to enhance the implementation of infrastructure projects and strengthen adherence to budgeted targets. Given the significant share of construction in most investments, addressing existing bottlenecks in this key sector, and improving coordination of project implementation would help improve efficiency and reduce delays.

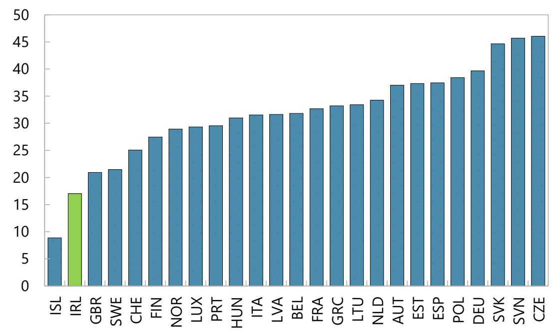
14. Decisive reforms are needed to ensure the future sustainability of the pension system and safeguard long term fiscal sustainability. While Ireland has one of the youngest populations in Europe, it is still aging fast, with its old-age dependency ratio expected to more than double over the next decades. The retirement age of 66 years has not adjusted to Ireland's increasing life expectancy (80 years). As a result, the length of time in retirement is expected to become one of the longest among European OECD countries. In the absence of reforms, it is estimated that by 2030 the annual financing gap in the social insurance fund will reach €3.3 billion, increasing to over €22 billion by 2071 (equivalent to a cumulative funding gap of about €335 billion in present value terms).[14] Increasing the retirement age in line with previous plans will be a necessary step to gradually restore sustainability. Linking increases to improvements in life expectancy would be essential to ensure the long-term sustainability of the system. Furthermore, with a relatively low share of social security contributions in tax revenues, there is scope for an increase in mandatory contributions.

Time in Retirement
(Year)



Sources: OECD 2019 Pensions At a Glance.

Social Security Contributions
(Percent of Taxation)



Source: OECD.

E. Conclusion

15. Ireland's low tax revenue ratio may limit the government's scope to meets its growing spending needs. Therefore, securing stable resources and ensuring high quality of expenditure will be required to meet social and infrastructure investment needs as well as future demands on public finances from demographic changes. Efforts should focus on broadening and diversifying the tax base, maximizing public investment returns and improving the adequacy and targeting of social spending. An effective way to increase tax revenue is making more use of less distortionary taxes, such as property taxes while reducing tax expenditures. To make the best use of public spending, progress should continue on the remaining steps to further enhance public investment, strengthening adherence to budgeted targets and improving existing social protection programs so resources reach the most vulnerable segments of the population.

[14] Actuarial Review of the Social Insurance Fund 2015.

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INEQUALITY, POVERTY, AND REGIONAL DISPARITY[1]

1. Inequality and poverty in Ireland have continuously declined in the recent years. Aggregate inequality indicators from Eurostat point to a decline in the Gini coefficient as well as in the ratio of the income of the top 20 percent earners to the bottom 20 percent earners. The Gini coefficient before social transfers was estimated at 38 percent in 2020, while after accounting for social transfers, it was estimated at 28.3 percent. Similarly, share of people at risk of poverty in Ireland came down to around 20 percent of the population in 2020, from 31 percent in 2011.[2] Social transfers, including pensions, have played a significant role in income redistribution. Using the World Inequality Database (WID), staff computed an index of the tax redistribution for the top 10 percent of income earners. The cross-country comparison of this index illustrates how progressive is a country' tax system in redistributing income across different income groups. In Ireland, the share of the top 10 percent income earners in 2020 post-tax dropped to 26 percent from the pre-tax level of 35 percent, indicating the progressivity of the tax system in Ireland. Moreover, from a cross-country perspective, Ireland ranks high in tax system's progressivity relative to its peers. The OECD's index of the housing cost overburden for low-income households illustrates that the average mortgage cost is higher than rent for the low-income households in Ireland[3]; notwithstanding that Ireland is doing better than the OECD average in keeping the housing cost overburden low[4]. While the aggregate indicators point to improvements in the inequality and poverty level in Ireland, there is still some scope to further improve housing affordability and regional disparity.

2. Ireland has made significant progress in improving well-being. The country performs well in many dimensions of well-being of their population— jobs, education, health, social connections, safety, and life satisfaction—relative to other countries in the OECD Better Life Index[5]. It, however, underperforms compared to the average in the areas of work-life balance. Moreover, the OECD report on regional inequality points to the need for more investment in housing and communities and in environmental protection[6]. In this context, the government has developed a Well-being Framework[7] to measure progress in improving quality of life across economic and social aspects, as well as environmental, health, and other important outcomes, and better align policy decisions with people's experiences. Authorities plan to monitor the indicators in the well-being dashboard and regional disparities is welcome in order to calibrate policy and investment needs.

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[1] This section is prepared by Marzie Taheri Sanjani.

[2] In terms of deprivation indicators, according to OECD, 13 percent of poor households spend more than 40 percent of their income on housing costs, and 47 percent of people would be at risk of falling into poverty if they had to forgo three months of their income. How's Life in Ireland? | How's Life? 2020 : Measuring Well-being | OECD iLibrary (oecd-ilibrary.org)

[3] Please see footnote 3 in the figure 1 for definition of the "housing cost over burden" indicator of OECD.

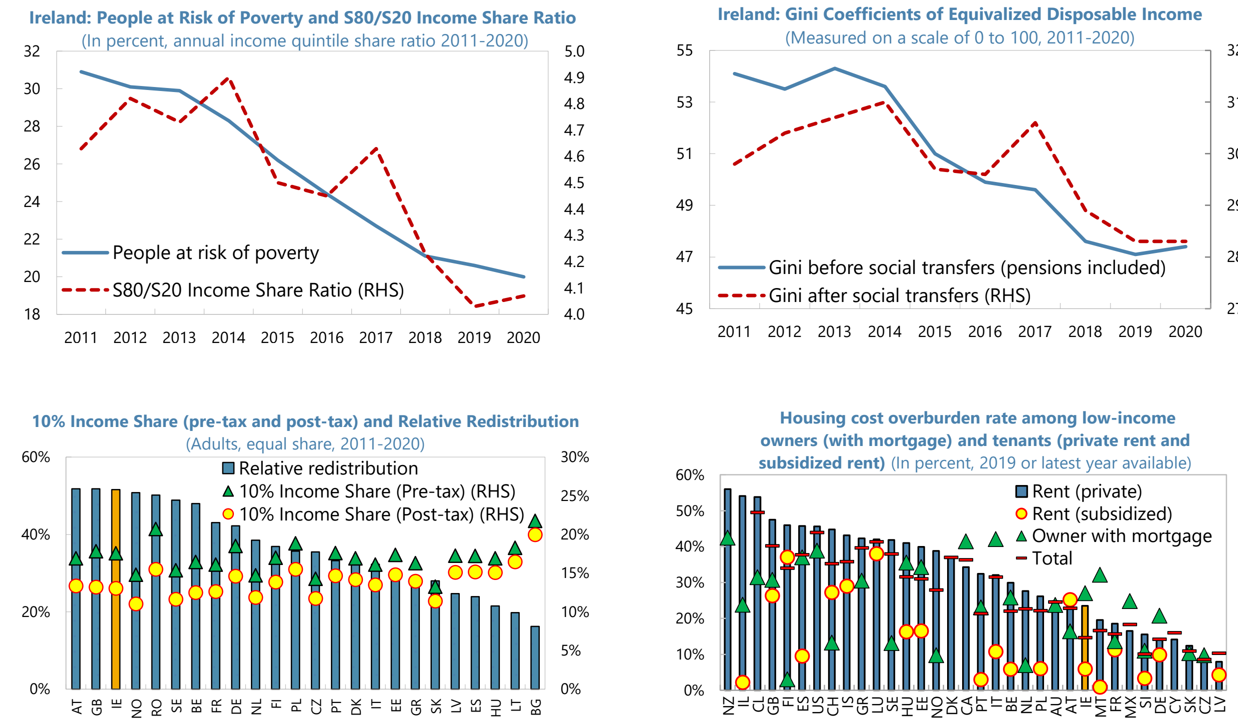
[4] Please see "affordable Housing Database" of OECD: Housing conditions - OECD

[5] OECD Better Life Index, contains Ireland ranking among OECD countries for various indicators.

[6] OECD Regions and Cities at a Glance 2020 (oecd-ilibrary.org)

[7] gov.ie - A Well-being Framework for Ireland - Join the Conversation (www.gov.ie)

Figure 1. Ireland: Inequality, Poverty, and Social Transfers



Source: Eurostat, OECD, World Inequality Database (WID), and IMF staff calculations.

Notes: 1) Top charts (RHS and LHD) are constructed using the inequality data from EU-SILC Eurostat database.
2) Bottom LHS chart is from WID database. The progressivity of the tax system is measured by the difference between pre-tax income share and post-tax income share of top 10 percent share, using "World Inequality Database". The higher is this metric the better is the tax system. The relative redistribution is a synthetic index computed as 100*[1- (post-tax 10 percent income share /pre-tax income 10 percent share)].
3) Bottom RHS chart is based on the OECD housing affordability database. It shows share of population in the bottom quintile of the income distribution spending more than 40 percent of disposable income on mortgage and rent, by tenure, in percent, 2019 or latest year available calculations based on European Union Statistics on Income and Living Conditions (EU SILC) survey 2019 except for Iceland, Ireland, Italy, and the United Kingdom (2018).

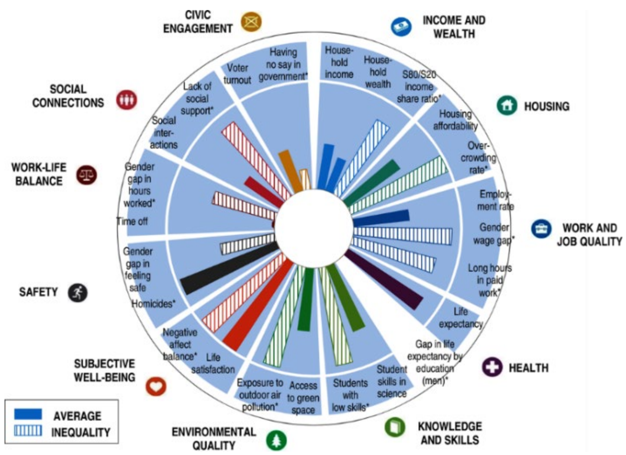
3. **However, there is some heterogeneity across the population.**[8] Measures of income poverty and material deprivation point to a high incidence of low living standards among single parents, their children, and those of working age in households without anyone in paid work. Women and young adults are the most vulnerable groups in the labor market, with high procyclicality of their employment and labor force participation rate.[9] Furthermore, employment of young adults has not recovered post-GFC, i.e. the employment rate of those people in the age

[8] See ESRI (May 2021), "Poverty, Income Inequality and Living Standards in Ireland"

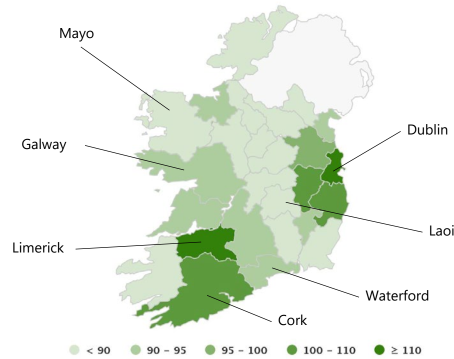
[9] England et al (2020) assesses that although there has been dramatic progress towards gender equality, this progress has slowed down in recent decades in some respects stalled entirely.

group of 20–24 years old stood at 71.1 percent (s.a.) in 2022Q1 relative to the peak of 81.7 percent in 2007Q1.

Figure 2. Ireland: How's Life in Ireland?



Household Disposable Income Per Person
(2019, Index: state average=100)



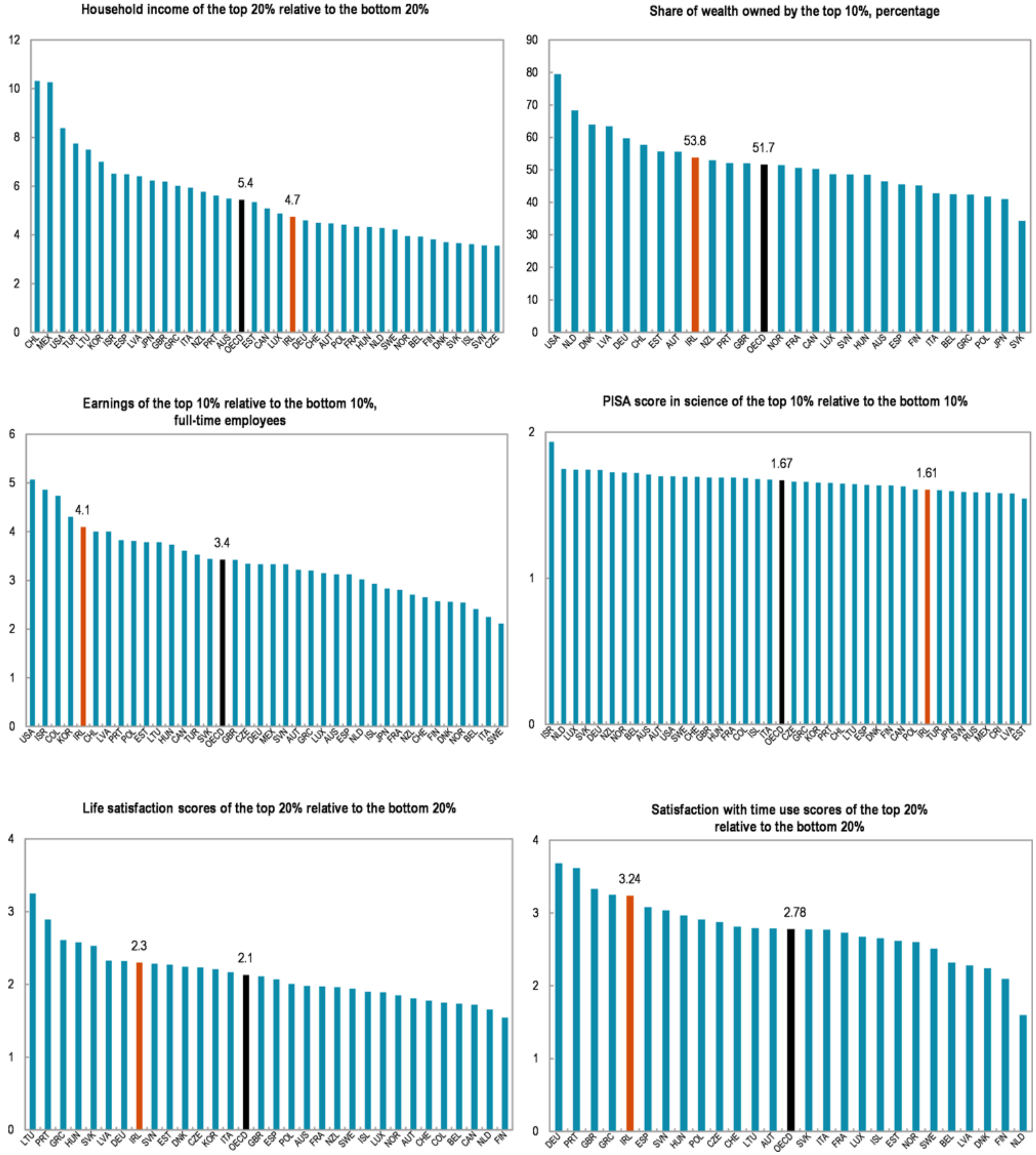
Source: CSO.

Source: OECD, [How's Life? 2020: Measuring Well-being]
Note: This chart shows Ireland's relative strengths and weaknesses in well-being compared to other OECD countries. Longer bars always indicate better outcomes (i.e., higher wellbeing), whereas shorter bars always indicate worse outcomes (lower well-being) – including for negative indicators, marked with an *, which have been reverse-scored. Inequalities (gaps between top and bottom, differences between groups, people falling under a deprivation threshold) are shaded with stripes, and missing data in white.

4. **Low-income households and young adults are facing housing affordability challenges.** While housing costs over-burden for low-income households in Ireland is among the lowest in the OECD and house price levels across the country are broadly in line with economic fundamentals for a median dual-earning households who are a first-time buyer (FTB); the affordability challenges for the low-income households or single-earner households are greater, particularly in the Dublin, GDA, Cork, and Galway areas. The pandemic has worsened housing affordability as public health restrictions had an adverse impact on residential construction while significant household savings, predominantly among wealthier households, put upward pressure on housing prices. To reduce the affordability gap, several subsidy schemes for FTBs have been introduced in recent years, such as the Help to Buy incentive and the Rebuilding Ireland Home Loan. However, some of these measures further stimulate demand. Ultimately supply-side policies to increase the housing stock and the provision of alternative rental models, such as social rental housing, are needed to improve housing affordability for vulnerable groups. Fiscal and structural policies should work hand in hand to make land available for construction and increase the housing supply.

Figure 3. Ireland: Inequalities Between Top and Bottom Performers in Ireland

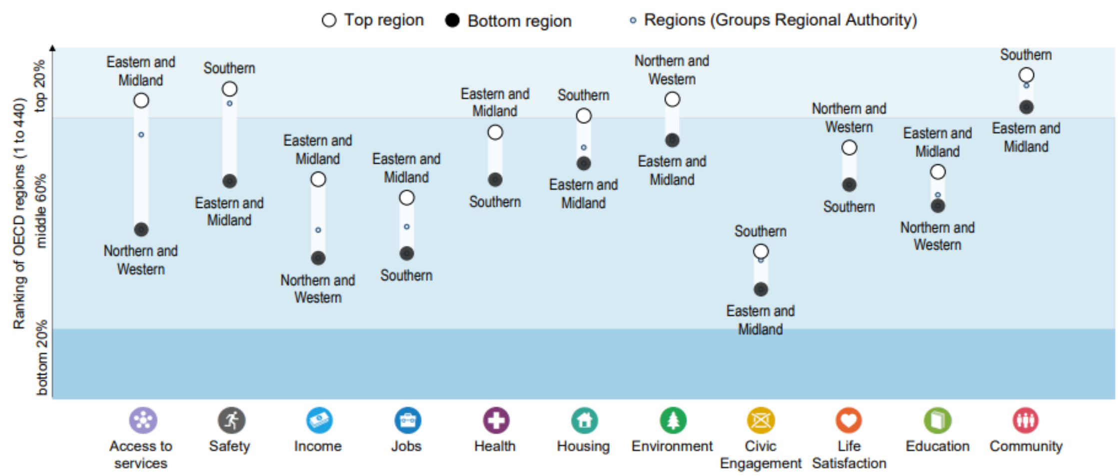
(Vertical inequalities for selected indicators of current well-being, 2018 or latest available year)



Source: OECD, [How's Life? 2020: Measuring Well-being]

Note: For all figures, countries are ranked from left (most unequal) to right (least unequal).

Figure 4. Ireland: Regional Gap in Well-being Indices



Source: OECD ([Regions and Cities at a Glance 2020 (oecd.org)]).
Note: Relative ranking of the regions with the best and worst outcomes in the 11 well-being dimensions, with respect to all 440 OECD regions. The eleven dimensions are ordered by decreasing regional disparities in the country. Each well-being dimension is measured by the indicators in the table below.

5. **Regional disparity in Ireland continues to rise.** The country shows large regional differences in access to services. The Eastern and Midland region is in the top 20 percent of OECD regions, and the Northern and Western regions rank at the median of the 440 OECD regions[10]. Dublin continues to remain the only region with higher per capita disposable income than the state average during the entire 2010–2019 period, while the Border and Midlands regions continue to earn significantly less than the state average. In contrast, the Mid West, Southwest, and Mid East regions showed incomes on par with the state average during the same period. From a sectoral perspective, Eastern and Midland rank highest in IT services and surpass other regions in most of the sectoral output, except in mining and manufacturing that southern region ranks the highest. While regional differences in labor market indicators are small, the Southeast region's condition is below the state average.

Composition of Regions

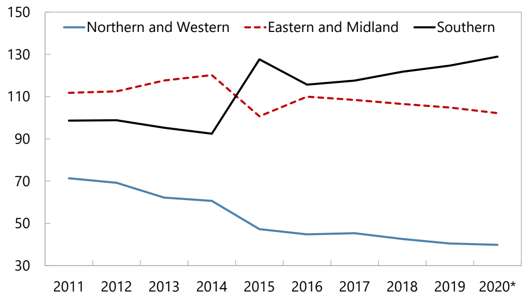
Northern & Western		Southern		Eastern and Midland	
Border	Cavan Donegal Leitrim Monoghan	Mid-West	Clare Limerick Tipperary	Dublin	Dublin City DunLaoghaire-Rathdown Fingal South Dublin
West	Galway Mayo Roscommon	South-East	Carlow Kilkenny Waterford Wexford	Mid-East	Kildare Louth Meath Wicklow
		South-West	Cork Kerry	Midland	Laois Longford Offaly Westmeath

Source:County Incomes and Regional GDP 2019 - CSO - Central Statistics Office

[10] Regions and Cities at a Glance 2020 (oecd.org)

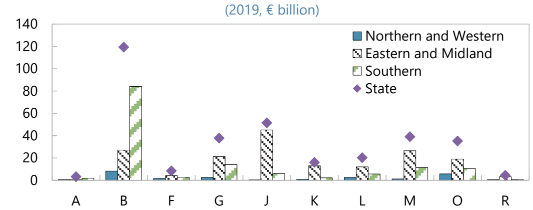
Figure 5. Ireland: Regional Disparity in Ireland

Regional GDP per Capita Index
(Index: state average=100)



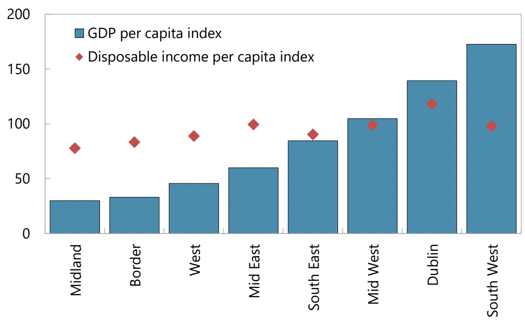
Source: CSO.
Notes: 2020 data are preliminary.

Gross Value Added by Sector by Region
(2019, € billion)



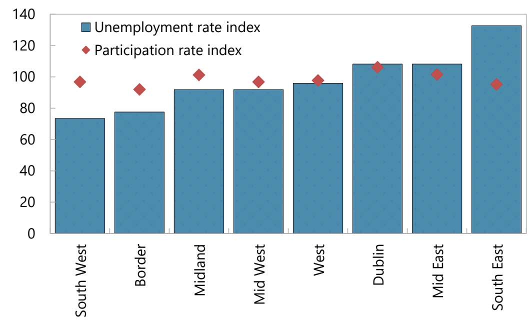
Source: CSO.
Notes: A: Agriculture forestry and fishing. B: Mining and quarrying; manufacturing; electricity, gas, steam and air conditioning supply; water supply; sewerage, waste management and remediation activities. F: Construction. G: Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service. J: Information and communication. K: Financial and insurance activities. L: Real estate activities. M: Professional, scientific and technical activities; administrative and support service activities. O: Public administration and defence; compulsory social security; education; human health and social work. R: Arts, entertainment and recreation, repair of household goods and other services.

Disposable Income and GDP Per Capita by Region
(2020, Index: state average=100)



Sources: CSO and IMF staff calculations.

Unemployment Rate and Participation Rate by Region
(2021Q4, Index: state average=100)



Sources: CSO and IMF staff calculations.