17 Kildare Street,

Dublin 2.

26th June 2018

Dr Seán Healy

Social Justice Ireland

Arena Road

Sandyford

Dublin 18

Dear Seán,

We would like to respond to both your Budget Choices document, issued as a pre-budget statement, and your proposals for a Social Welfare Pension issued in March. While SJI is clearly well-intentioned in its outlook and its policy prescriptions, from the point of view of those small business owners who, as part of the overall SME sector employ approximately half the adult Irish population (c.950,000 people), SJI policies are neither 'social' nor are they 'just.' Allow me to explain why this is their view.

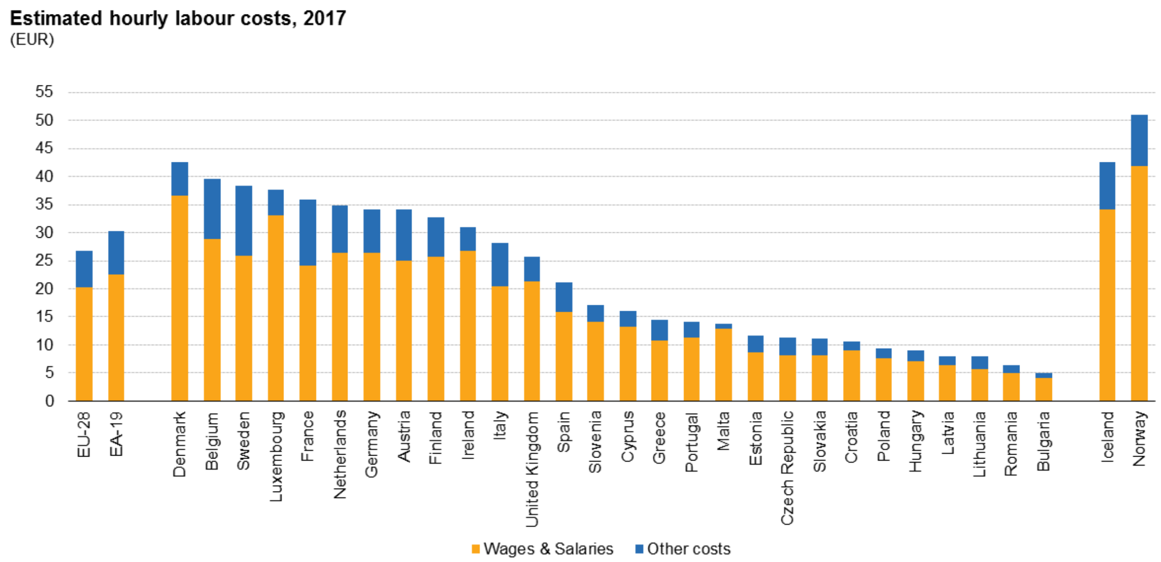
Ireland, in common with most western economies, has a pension problem. As life expectancy increases, and fertility rates decrease, there is a higher dependency ration between retired and working citizens. The latest evaluation conducted on Ireland's pension deficit (conducted by KPMG, 2015) puts our unfunded liability for public service pensions at €115bn, and our unfunded liability for social fund pensions at approximately €335bn, approximately €450bn in total. This liability figure is not included in our government debt figures of approximately €204bn.

Irish state pensions are paid on a pay-as-you-go basis, i.e. there is no accumulating fund set aside to meet future needs: pensions are paid from the current account. As the '*Roadmap for Pensions Reform 2018 – 2023*' produced by DEASP in March 2018 states: '*This PAYG model works for so long as there are roughly four or more workers contributing into the Social Insurance Fund for every pensioner drawing from it (depending on the level of other benefits such as unemployment benefit and invalidity pensions paid from the fund). However, like many other developed countries, Ireland is facing demographic challenges which will see the number of pensioners more than double and the ratio of people of working age to pensioners fall to about 2.3:1 over the next 40 years. This presents significant funding challenges…*' The issue is not whether, or how big the issue is, merely how we are going to tackle it. Your Social Welfare Pension and Budget Choices documents attempt to do both.

The Social Welfare Pension proposal was published first, and proposes as funding measures an increase in employers' PRSI, and the elimination of reliefs on private sector pensions.

Regarding the increase of employers' PRSI, it is true that Irish employers pay one of the lowest rates of social insurance on wages in the EU. It is also true, however, that the wage/salary cost borne by Irish employers is one of the highest. It is, in fact, fourth in the EU, lagging only Denmark, Luxembourg, and Belgium, none of which are peripheral economies (Table 1). SJI does not clarify, therefore, if it would expect gross wages to rise in such a scenario (which would have a likely labour-force impact) or whether it views an increase in social insurance costs to be cost neutral, or close to it. SMEs in Ireland have a far higher labour component in their cost of sales than large or multinational enterprises. In the case of some small service businesses, labour & benefits costs can be up to 86% of location sensitive costs[1]. For the avoidance of any doubt, ISME is stating clearly that if employers' PRSI rose from its current 10.85% to the EU average of 25.05%, a material labour-force impact would be inevitable. If however, workers were willing to allow such an adjustment to take place without a 1:1 cost impact, the impact on the labour force would be reduced by the same amount. It would be useful for SJI to publically state its views on this trade-off.

Table 1.



Note: whole economy (excluding agriculture and public administration); in enterprises with 10 or more employees. Provisional data.
Source: Eurostat (online data code: lc_lci_lev)

[1] http://www.competitiveness.ie/Publications/2017/NCC-Costs-of-Doing-Business-2017-Report.pdf

However, we also point out that our status as a 'low-tax, low social contribution' economy is only true at or below the 'average wage' as cited in the OECD study ('Taxing Wages 2017) Figure 1 right, which is most often cited. At the average wage, Ireland's income tax, employee social contribution, and employer social contribution are some of the lowest in the OECD.

Ireland has a highly 'progressive' tax system. Superficially, this is a good thing, and it is highly re-distributive.

However, it means that those below the average wage pay little tax, and those above it pay a lot.

It also means that in Ireland's case, a large proportion of the total tax take falls on a relatively small proportion of society.

While SJI might consider this to be socially 'just' it constitutes a material risk to the stability of our income tax base and our annual tax take.

The Irish Institute calls this the 'Step Effect' which illustrates the problem very clearly in the figures below from the Irish Tax Institute's pre-budget briefing papers 2017.

Figure 1

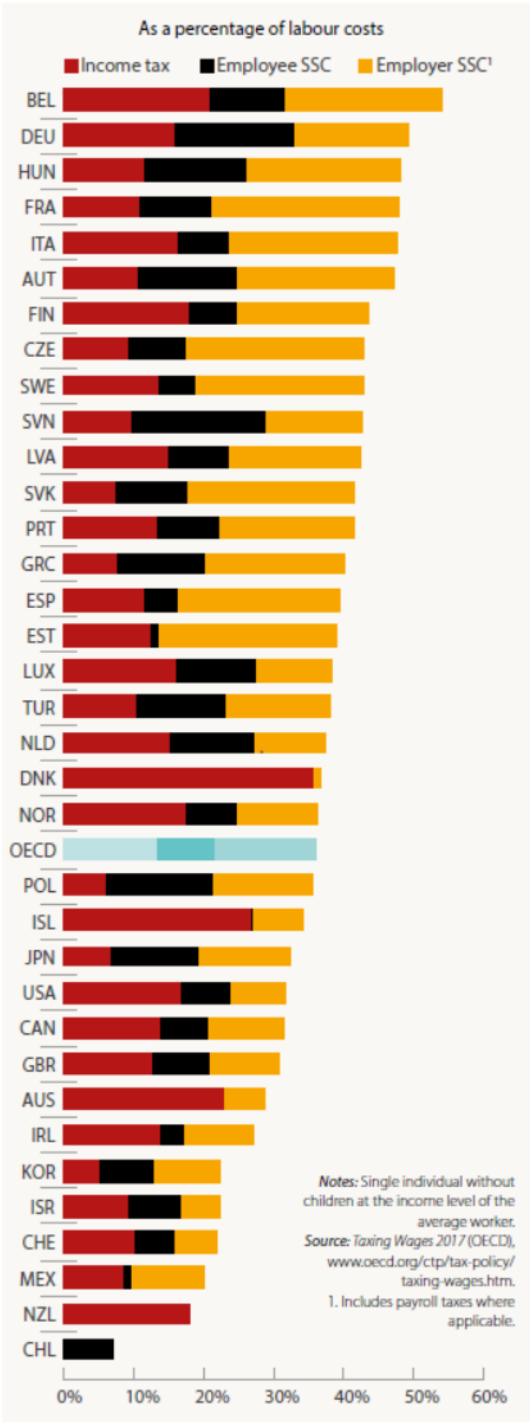


Table 2 below shows how the top rate of tax for a single tax payer rises sharply above €25,000. We have annexed the full set of Tax Institute tables at the rear in Annex I.

Table 2: The Income Tax Step Effect

The Step Effect	
Income Level	**Top Tax Rate**
€18,000	22.5%
€25,000	29%
€36,919 (average salary)[2]	49%
€70,044	52%
€100,000 (self-employed income)	55%

Secondly, the Tax Institute shows that the notion of Ireland as a low-tax country above the minimum wage is entirely bogus (Table 3). Only Sweden is close to Irish marginal tax levels, and the entry points at which they apply. Yet Sweden has a far more elaborate social welfare model. The UK and Germany represent more proximate comparators in every sense of the word, and both have lower marginal rates and higher entry points.

Table 3: Comparative Marginal Rates

How Ireland's entry point to the top marginal rate compares			
	Country	**Top Marginal Rate**	**Entry Point**
	Ireland	**52%** **55%**	**PAYE Income over €70,044** **Self-employed Income over €100,000**
	Germany	47.5% 44%	Income over €256,303 Incomes between €54,058 - €256,303
	Sweden	60% 55%	Income over €63,580 Incomes between €43,890 - €63,850
	UK	47% 42%	Income over £150,000 (€165,235)* Incomes between £45,032 - £150,000. (€49,606 - €165,235)*
Source: OECD 2016 figures (http://stats.oecd.org) * EURO FX rate to GBP 0.9078 (as at 11/09/2017)			

The difficulty is not therefore with the taxes and social insurance contributions of higher earners, it is with those at and below average earnings. This fact is politically inconvenient, and indeed successive governments have exacerbated the issue by taking more taxpayers out of the net. The introduction of USC at the peak of our economic crisis was a belated acknowledgment of how narrow our tax base became during the boom years.

While the politicians wish to avoid the issue in the interests of their re-election, ISME would be interested to know if SJI considers our current taxation system to be socially just, or even prudent?

Regarding SJI's proposal to fund a Social Welfare Pension by removal of pension contribution tax reliefs, it is very interesting how this argument (which is cogently made, and accurately costed) is presented.

1. Firstly, it presents the case as an exchequer cost, or tax forgone. This is a misleading, not to say false, argument. The exchequer grants tax relief to private sector pensions on the way in, and taxes them on the way out. There is, or course, a benefit to the worker in this arrangement, as returns accrue to the pension on the gross, rather than the net amount (although returns are poor at present).
2. Secondly, it presents this tax lost as a function of overly generous tax reliefs and 'expenditures' (on page 22) noting the OECD reported that the EET [exempt-exempt-taxed] model in Ireland functioned more like an "'exempt-exempt-exempt" (EEE) system where income channelled through pensions is unlikely to be taxed at any point of the life-cycle." Ignoring the fact that SJI makes no such comparisons with the benefits conferred by the public sector pensions system, the fact that pension income generates a lower overall tax take is a function of the progressivity of the tax system referred to above. It is NOT a function of the generosity of the tax reliefs of the private pension system.

Table 4: Tax Take

GROSS				120,000	60,000
USC	1st	12,012	0.50%	60	60
USC	next	7,360	2%	147	147
USC	next	50,672	4.75%	2,407	1,930
USC	next	Balance	8.00%	3,996	
PAYE	1st	34,550	20%	6,910	6,910
PAYE	balance		40%	34,180	10,180
PRSI			4%	4,800	2,400
Tax Credit				- 1,650	- 1,650
		Tax		50,851	19,977
		Net Income		69,149	40,023
		Tax as a % of Gross		42%	33%
		Net Income as % of Gross		58%	67%

3. To illustrate this unintended outcome of the progressivity effect, consider the two single earners represented by Table 4 above, one on a salary of €120k pa, the second on €60k pa. Note that the tax take from the €120k salary is 2.54 times that of the €60k salary. Let us now look at what happens when

the high earning private sector worker tries to save the sort of money it would take to generate a pension to the value of a public service DB scheme. At the age of 60, our high earner can divert 40% of salary into a pension.

4. Now, imagine that the 120k worker decides to avail of our private pension tax reliefs to forsake 40% of her salary to her pension scheme. Let us look in Table 5 at what happens to her tax take. Her gross salary falls from €120k to €72k, allowing her to divert €48k into her pension. Let us, for the sake of argument, assume that this level of savings will generate an ultimate pension of 50% of her contribution (since a private sector worker cannot aspire to a pension that has any material proportionality to their final, or indeed their average, income level pre-retirement). We can see that the tax take has plummeted from €51k to €32.5k (made up of €25.9k levied on salary, and €6.6k levied on pension. Even this is highly unrealistic, because an annual contribution of €48,000 by a 60 year old worker would not come close to generating an annual pension of €24,000 for her.

Table 5

GROSS				**120,000**	**72,000**	**24,000**
USC	1st	12,012	0.50%	60	60	60
USC	next	7,360	2%	147	147	147
USC	next	50,672	4.75%	2,407	2,407	220
USC	next	Balance	8.00%	3,996	156	
PAYE	1st	34,550	20%	6,910	6,910	6,910
PAYE	balance		40%	34,180	14,980	
PRSI			4%	4,800	2,880	960
Tax Credit				- 1,650	- 1,650	- 1,650
		Tax		50,851	25,891	6,647
		Net Income		69,149	46,109	17,353
		Tax as a % of Gross		42%	36%	28%
		Net Income as % of Gross		58%	64%	72%

5. In reality, the pension generated by a given level of saving, even over a prolonged period, is significantly less than 50% of the cash saved. Thus the aggregate tax take from this high earner would be less than the €32.5k quoted above. Nonetheless, the OECD proposition that '*income channelled through pensions is unlikely to be taxed at any point of the life-cycle*' is proven. But it is only proven in the context that our income taxation system is highly progressive, and the pensions ultimately derived from private sector DC pensions are so much smaller than their public sector DB equivalents.

6. Hopefully in Tables 4 & 5 above you can understand the anger of private sector workers at the inequity of your proposals to fund a Social Welfare Pension by focussing on the tax treatment of the private sector ***contribution***, rather than on the value of the public sector ***benefit***.

To take this point further, in providing funding for a Social Welfare Pension, SJI constantly reiterates the terms *tax expenditure, tax reliefs*, and *tax-based subsidy*. The paper presents the value of this subsidy as approximately €2.6bn per annum. However, and by contrast, the OECD looks at the unfunded value of our social insurance pensions in Table 6 below. By comparison, focussing on the cost of private sector pension tax relief while ignoring this deficit amounts to examining the pimple on the elephant's posterior, while ignoring the elephant.

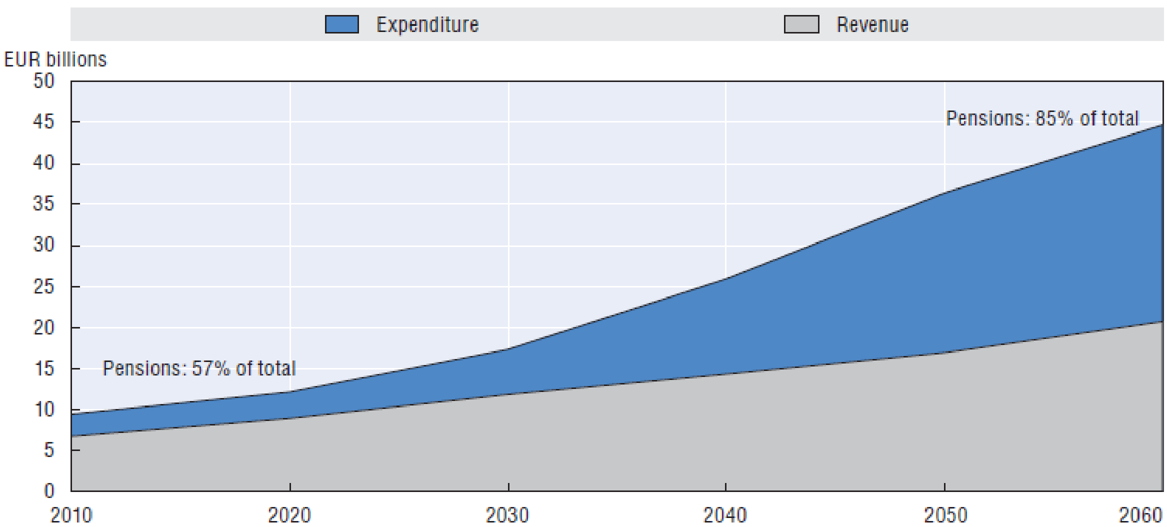
Table 6: Projected Growth in Accumulated Deficit in Social Insurance Fund

Period	EUR billion	% of 2011 GDP
5 years	9	6
10 years	20	13
20 years	52	33
30 years	103	66
To 2066	324	207
Memorandum item		
Public debt	169	108

Source: Based on data from KPMG (2012), *Actuarial Review of the Social Insurance Fund 31/12/*, Undertaken by KPMG on behalf of the Department of Social Protection, June 2012, Ireland on behalf of the Department of Social Protection.

The costs of meeting the unfunded pension liabilities of the Social Insurance Fund and the public sector simply cannot be borne by private sector workers alone. Nor can we as a nation cover these costs without recognising what they actually are. Figure 2 below graphically illustrates the rate at which the expenditure demands of the Social Fund are increasing.

Figure 2



Source: Based on data from KPMG (2012), *Actuarial Review of the Social Insurance Fund 31/12/*, Undertaken by KPMG on behalf of the Department of Social Protection, June 2012, Ireland on behalf of the Department of Social Protection.

Given our current mortality rates, DB pensions are the new gold. We must recognise the long-term liability they impose on the state if we are to understand how to fund them. Calculations by the Association of Pension Trustees of Ireland (APTI) show private-sector workers and their employers would have to spend millions of euro to earn the same retirement benefits as workers with similar levels of pension within the public service. Table 7 below shows the open market value of some typical public sector pension entitlements.

Table 7: Open Market Values of Public Service Pension Entitlements

Title	Age starting pension	Retirement lump sum	Annual pension	Value of pension as per Irish Revenue factors	Single life open market annuity cost	Joint life open market annuity cost
Public servant	65	€60,000	€20,000	€580,000	€765,965	€850,514
TD	60	€135,000	€45,000	€1,485,000	€2,108,684	€2,381,630
Garda	60	€102,000	€34,000	€1,122,000	€1,593,228	€1,799,454
High Court judge	70	€255,000	€85,000	€2,125,000	€2,605,664	€2,927,956
Hospital consultant	63	€240,000	€80,000	€2,400,000	€3,328,903	€3,701,705
Senior public servant	65	€150,000	€50,000	€1,450,000	€1,914,914	€2,126,285
Taioseach	66	€378,000	€126,000	€3,528,000	€4,620,424	€5,168,875
Teacher	62	€90,000	€30,000	€930,000	€1,298,703	€1,447,466

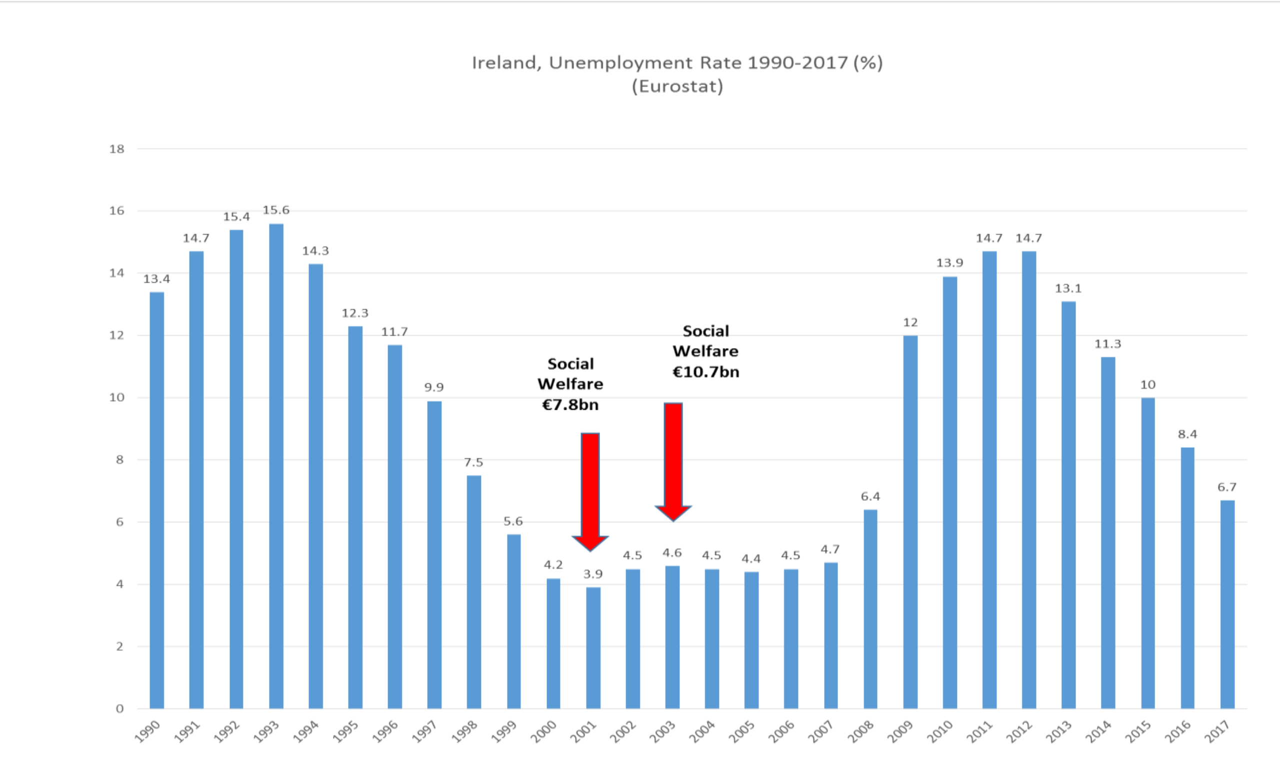
It therefore makes no moral, ethical or actuarial sense for SJI to suggest, as it does on Page 46 of its Social Welfare Pension proposal, reducing the standard fund threshold to €500,000, when even a retiring clerical officer has a fund worth more than that according to the Revenue pension evaluation tool. This inequity cannot continue, and SJI debases their both their credibility and commitment to social justice by supporting it.

Only 35% of private sector workers have a pension. While we acknowledge the issue that a substantial proportion of pensions' tax relief accrues to a small number of workers at present, this is purely a function of poor pensions' penetration in the private sector.

Therefore, we must consider how to increase the level of coverage. Do we think, as a matter of public policy, that removal of tax incentives will increase or decrease the penetration of pension coverage in the private sector? Do we think, as a matter of public policy, that removal of existing tax incentives will help bridge the funding deficits in our Social Insurance and Public Service pensions? ISME considers both propositions to be highly unlikely: Private sector workers are not stupid. The benefits of investment in private sector pensions are already marginal (in terms of pension earned). Were the tax reliefs on pensions to be further eroded, it is more likely that workers' savings will be directed away from pensions, and into some other form of savings or tax relief.

This is the theory of the worker as a 'rational actor.' While often criticised, in matters of the economic behaviour of workers in Ireland, it is rarely wrong. An example of the rational behaviour of workers in the marketplace can be found below in Figure 3, which we think is illustrative of the risk to your whole Social Welfare Pension strategy, by making it dependant on the withdrawal of a tax 'subsidy' to one sector of workers.

Figure 3.



With our unemployment level now at 5.3% and trending downward, we are approaching levels of unemployment last seen in 2007. By 2007, Ireland had effectively been at full employment for eight years. But unemployment went below 4% in 2001, and rose again in 2002. Why did this happen in a market at full employment? Interestingly, social welfare spend increased from €7.8bn to €10.7bn in Budget 2002. While this can be expressed as a nominal increase of 'only' 0.7%, in fact that meant a rise of 18% in the level of unemployment in the labour market at that time. To us, that is a clear example of environmentally driven behaviour among a cohort in society who voluntarily dropped out of the labour market at a time of full employment. They did so not because they were lazy, or immoral, they did so because it was economically rational to do so. There are unforeseen, and often negative, consequences for policy prescriptions, even where their intentions are benign.

To summarise our position in relation to the funding of pensions from the public purse:

1. ISME is not against the taxation of pension contributions in principle, but,
2. Such taxation must be just and fair,
3. It must not discourage the already small number of people who invest in private pensions,
4. It must be based upon equitable treatment of the *value of the pension*, not merely the contribution
5. It must be sustainable and affordable for society, and not simply a continuation of the current practice of passing debt to our children
6. It must address the ongoing and growing disparities between public and private sectors, before that becomes entirely repugnant to the latter

If, however, SJI remains wedded to the notion that private sector pensions persist solely because of the largesse of tax subsidies; ISME suggests that private sector workers would happily vacate all the tax advantages currently available to them on the basis of equality with the public sector as follows:

- All private sector workers would be levied a pension-related deduction (PRD) of 10%, or 10.5%, based upon their gross income.
- This PRD would be subject to a standard-rate only tax break.
- Private sector workers would, in return, become eligible for a pension of up to 50% of final salary, averaged over the previous three years, funded from general taxation.

Regarding the taxation proposals in your 'Budget Choices' document, ISME would make the following observations:

1. Your focus on the elimination of SARP as generator of €10m is contradicted by the agencies tasked with getting MNC operations into this country. ISME represents no MNC operations. Yet because of the inherently punitive tax levels referred to above, Ireland is an unattractive location into which to move foreign-based talent. We have no issue with SJI prioritising fairness within the tax system over attracting foreign MNCs, but suggest that SJI should state this openly and honestly in their proposals.

2. On your proposal to raise CGT from 33% to 35%: while we acknowledge that you got the €69m figure from the Revenue's Ready Reckoner, we challenge the veracity of the assumption. CGT yield, at €826m, would rise much faster if the rate was dropped. Our CGT is fourth highest in the OECD, and negatively impacts investment and scaling in Irish businesses.
3. Regarding your proposal to increase CAT from 33% to 35%: If indexed at the CPI rate from when it was introduced, our CAT threshold would now be over €1.3m, instead of the current €310,000. The effect of this is to diminish the attractiveness of intergenerational transfer of businesses, and is one of the reasons so few Irish family businesses reach the scale and employment levels of their continental cohorts.
4. We note that SJI's proposals on the earned income tax credit do not extend as far as suggesting that the self-employed should have the same credit as PAYE workers. In our view, this omission undermines your stated principles of 'just taxation' and 'increased equity in taxation.'
5. While we note your proposals on PAYE and tax credits, we direct your attention to the observations by the OECD and others that the real area of under-taxation in Ireland is in that of incomes below the average industrial wage. Focussing income tax proposals on persons who make up less than 0.6% of the tax paying units in the state will not provide meaningful reform of our income tax system, but will merely encourage the notion that 'someone else will pay.'

We acknowledge your observations on persons with disability in the workplace, and urge you to look at the work being carried out in this regard by the Employer Disability Service run by ISME on behalf of its consortium with Chambers Ireland and Ibec.

As we frequently find ourselves attending the same committees and meetings to discuss these issues, perhaps we should meet at a time of your convenience to discuss them informally.

Yours sincerely,

Neil McDonnell

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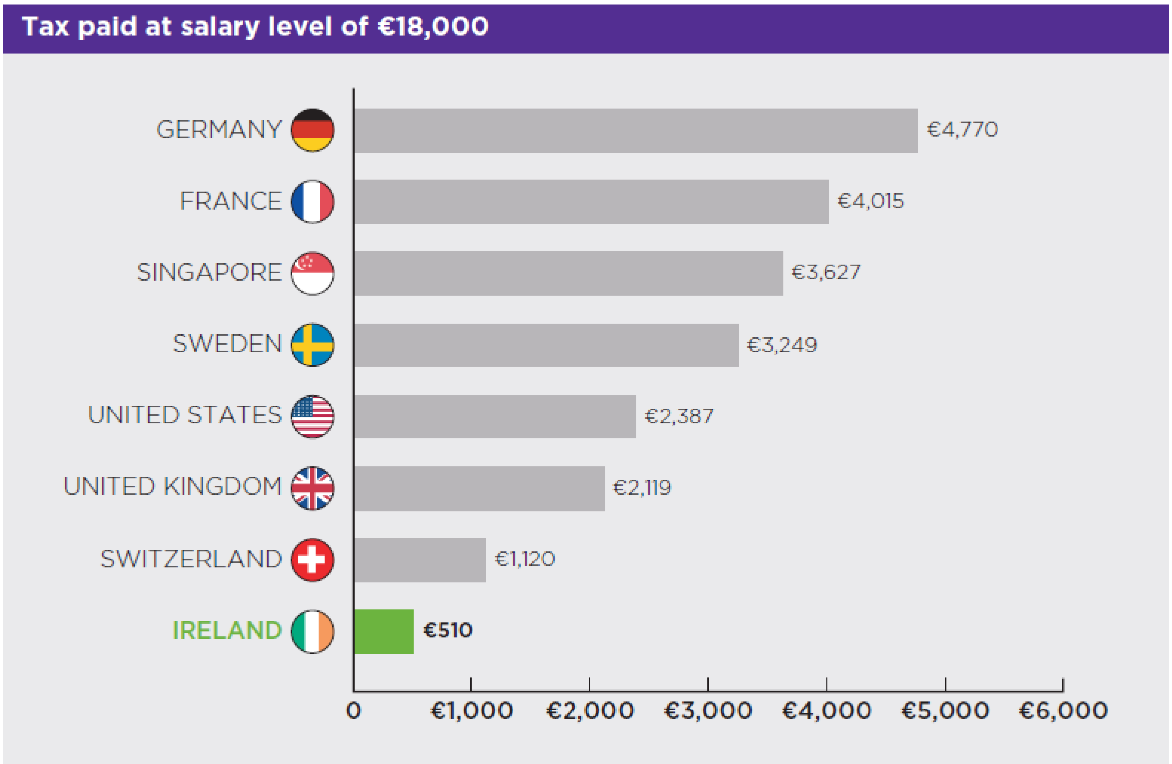
Neil McDonnell
Chief Executive

Annex I


Tax paid at salary level of €18,000
GERMANY
€4,770
FRANCE
€4,015
SINGAPORE
€3,627
SWEDEN
€3,249
UNITED STATES
€2,387
UNITED KINGDOM
€2,119
SWITZERLAND
€1,120
IRELAND
€510
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€1,000
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€5,000
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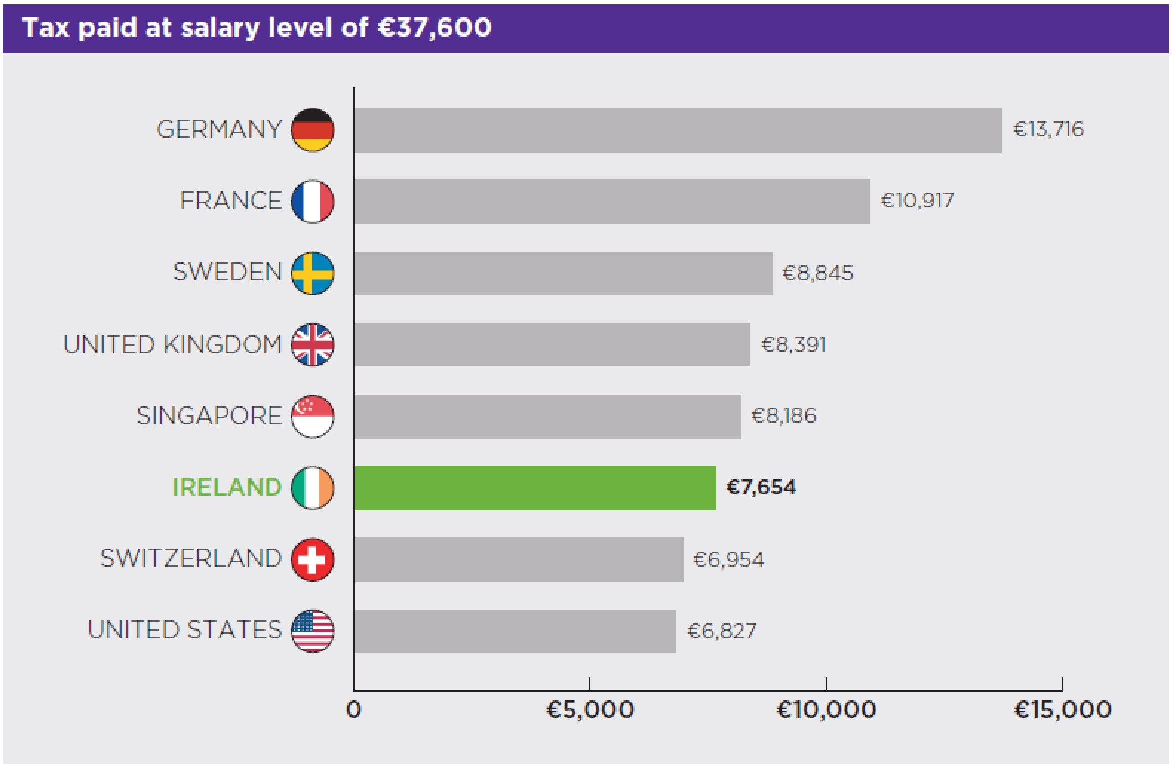
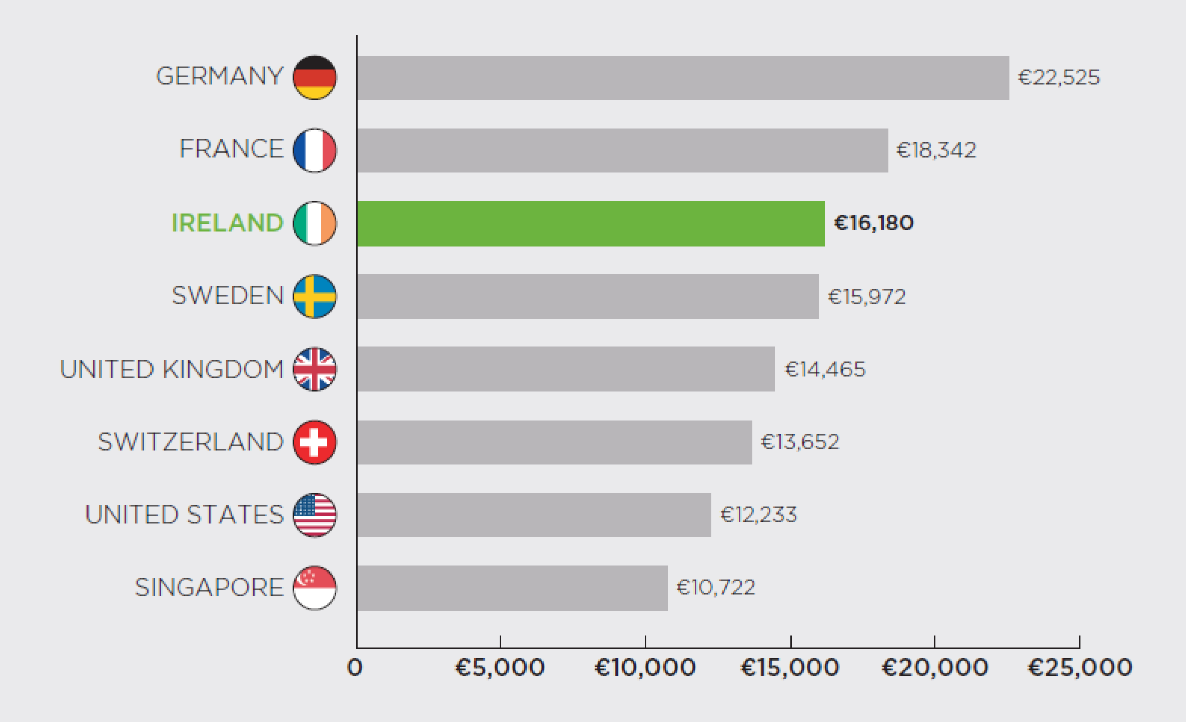
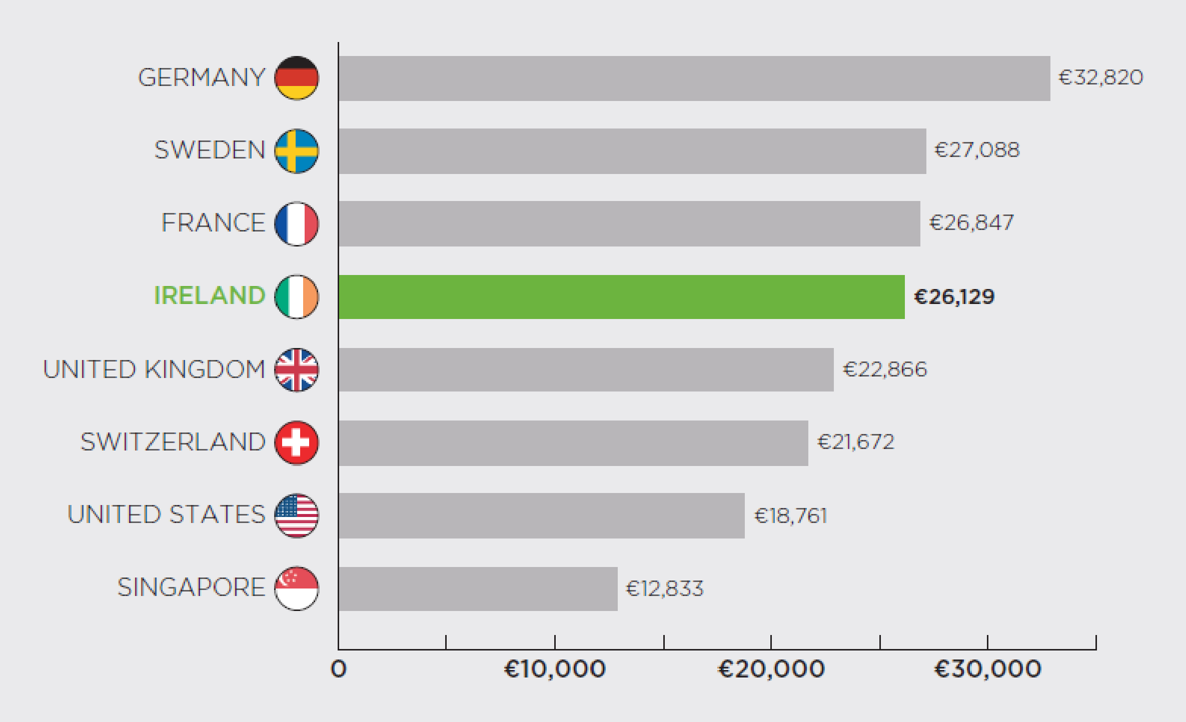

Tax paid at salary level of €37,600
GERMANY
€13,716
FRANCE
€10,917
SWEDEN
€8,845
UNITED KINGDOM
€8,391
SINGAPORE
€8,186
IRELAND
€7,654
SWITZERLAND
€6,954
UNITED STATES
€6,827
0
€5,000
€10,000
€15,000

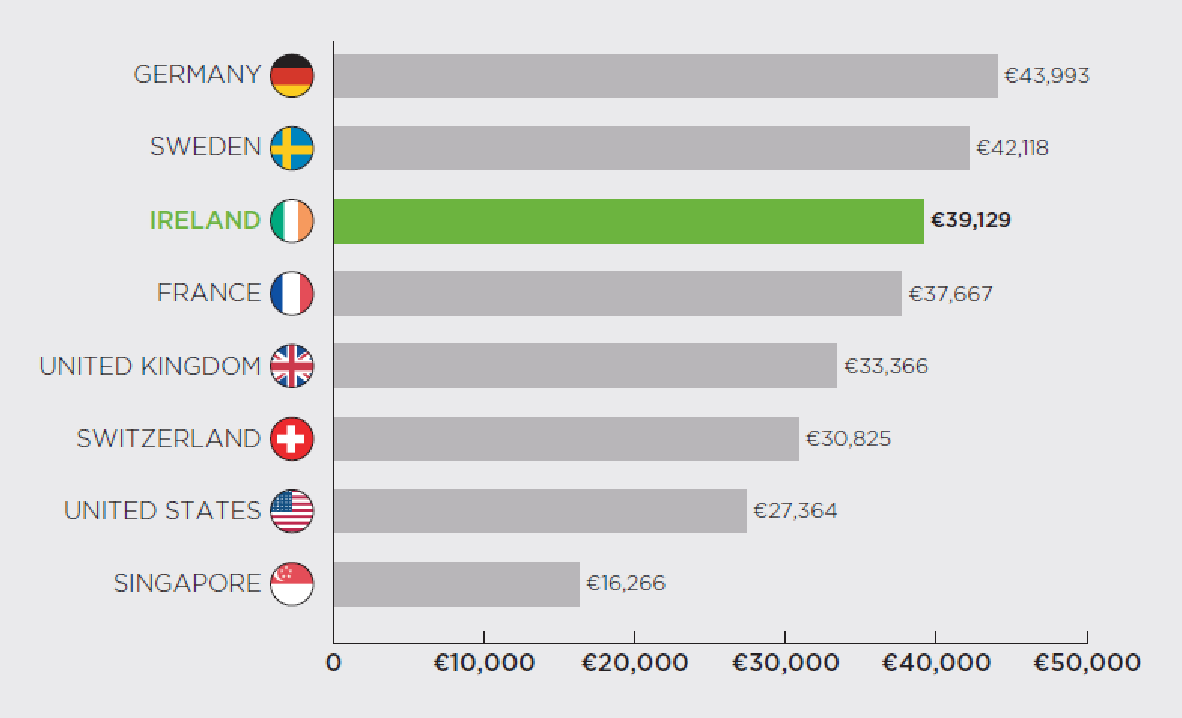
Tax paid at salary level of €55,000



Tax paid at salary level of €75,000



Tax paid at salary level of €100,000



Tax paid at salary level of €150,000