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PANEL RESPONSE: FISCAL POLICY

Taxation, Reform, and the Commission on Taxation and Welfare

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I HONOURING PATRICK

It is a great professional and personal privilege to be invited to participate in this event honouring Patrick Honohan.[1]

Patrick is something of a renaissance figure in the scale, breadth, and depth of his contribution to the Academy and to public life, in Ireland and internationally. There are few in the Academy who can cross from the groves and towers of academia to ascend to the pinnacle of policy and public life. Patrick has done so with his signature distinction, intellectual heft, generosity of spirit, and commitment to the public interest. And although we are here in the magnificent Royal Irish Academy which Patrick has served with such distinction, I dare to claim Patrick as "one of our own" at my own institution, the London School of Economics and Political Science (albeit Patrick was the "one that got away…"). Patrick is an MSc and PhD alumnus of LSE. But more than that, his career is a shining exemplar of LSE's motto – "rerum cognoscere causas" ("to know the causes of things") – and founding purpose – "for the betterment of society". Patrick, it is a source of immense personal and institutional pride, as an LSE academic, to be here to honour you today.

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Shameless LSE adventurism aside, as Chair of the 2021-2022 Commission on Taxation and Welfare (CoTW) I am particularly fortunate to be participating in this panel on fiscal policy in Ireland. Patrick's canonical contributions on the interaction between fiscal policy and the economy[2] are core texts for anyone thinking about fiscal policy in Ireland. They provided the Commission with much food for thought, including as to the challenges inherent in undertaking large-scale review exercises of the kind we were engaged in.[3] We also owe Patrick a debt of gratitude for his pioneering leadership in fiscal studies in Ireland, as do all who work in fiscal policy. Through his long association with the Foundation for Fiscal Studies, Patrick has been tireless in promoting the data collection and interrogation, research, and informed debate that is critical to rigorous and frank discussion of taxation – that most freighted and contested of policy areas. Fiscal policy aside, as an academic whose "day job" is in financial market regulation, I would like to honour Patrick's immense legacy in shaping how we now regulate the financial system following the cataclysmic crystallisation of risks over the Global Financial Crisis, including through his leadership of the Central Bank of Ireland at a moment of existential crisis for the Irish and wider EU financial system.

II REVIEWING FISCAL POLICY AND REDISTRIBUTION IN IRELAND AND THE COMMISSION ON TAXATION AND WELFARE

Barra's paper on Reviewing Fiscal Policy and Redistribution in Ireland charts the changing shape of the "tax and transfer" state in Ireland and the striking shift from consumption/property taxes to personal and corporation taxes. The paper shows how these measures have significant implications for income distribution (using the Gini coefficient) and highlights the ambiguities in how this is measured (including as regards the exclusion of VAT). And it shows, to compelling effect, how little is still understood about how taxes and transfers can, in practice, change incentives (including as regards inheritance taxes, for example, given the behavioural incentives associated with how capital gains tax is applied to assets on a death and the related "rebasing" of capital gains). The paper ends with a call to arms for more research.

This excellent paper follows in the agenda-setting tradition of Patrick's work in that it identifies the shifts and turns of fiscal policy and where the policy challenges lie. In that sense it resonates strongly with the work of the CoTW which provides the frame for my remarks. Our Report, *Foundations for the Future*, was

[2] E.g. Honohan, P., 1987. "A Radical Reform of Social Welfare and Income Tax Evaluated", 35 *Administration* 69.

[3] Honohan, P., 1999. *Assisting the process of tax reform.* Foundation for Fiscal Studies.

published in 2022,[4] and contains 116 recommendations for reform, situated within an analysis that reflects on fiscal and economic policy from 1989.[5]

You will be relieved I am not going to try your patience by engaging in an excursus of the Report's contents. But, recognising the importance of Patrick's work in identifying policy challenges, and his leadership in championing effective reform processes, I will venture a summary. At the heart of our work was the first and foundational question asked by our terms of reference:

> *How best can the taxation and welfare systems support economic activity, and promote increased employment and prosperity, while ensuring that there are sufficient resources available to meet the costs of the public services and supports in the medium and longer term.*

Our Report answered this question in two ways. The pithy answer is our First Recommendation: the Commission recommends that given the medium to long-term threats to fiscal sustainability, the overall level of revenues raised from tax and PRSI, as a share of national income, must increase materially to meet these challenges. These increased yields should be obtained in a manner that minimises economic, social, and environmental costs. This framing "net revenue-raising" recommendation is supported by the longer answer of 115 other recommendations on how this should be achieved, and by the extensive analysis and data in the Report, running to some 500 pages.

The Report proposes a series of measures to expand the tax base, and to shift the balance of taxation, to ensure that a greater share of taxation is drawn from more efficient taxes – in particular property taxes (we proposed the adoption of a Site Value Tax) and capital taxes (we proposed significant reform of capital gains tax, capital acquisitions tax, and inheritance tax) – and so to secure the sustainability and also the fairness of the taxation system. The Report also proposes progressive reforms to our social welfare system to support employment and address child poverty (including the introduction of a second-tier means-tested child benefit payment). Central to our thinking was that the broader the base of taxation, the lower the rate required to generate any given level of revenue. A broad tax base is also more sustainable in the face of shocks, less exposed to volatility, and has greater capacity to respond to structural change in the economy.

As the Report shows, the experience of the last 30 years, not least the loss of national creditworthiness over the financial crisis, demonstrates the level of exposure of the Irish State to significant shocks. But there are also predictable challenges ahead. Chief among the looming challenges we identified is a structural

[4]Available at: https://www.gov.ie/en/publication/7fbeb-report-of-the-commission/

[5] While any starting point is somewhat arbitrary, 1989 was a useful inflection point for the CoTW's work as the year the Cold War ended and a period of economic globalisation was ushered in.

change to our demographic profile. Ireland currently has a young demographic profile compared to EU counterparts, but we are set to converge to the EU. And with this comes a change to the dependency ratio: currently there are four people of working age for every person over 65; by 2050, this will be closer to two. Relatedly, age-related expenditure is expected to increase from 21.45 per cent of national income in 2019, to 24.7 per cent in 2030, to 27.2 per cent in 2040 – or in round numbers, by €7 billion come 2030.[6] Alongside there are other significant fiscal risks, notably concentration of tax revenues.[7] As is now well known, corporation tax (using end 2023 figures) represents 27 per cent of tax revenues (€23.8 billion);[8] in a shift in the profile of tax revenues, it now accounts, for the first time, for more tax revenue than VAT (23 per cent; €20.3 billion).[9] And in 2023, 52 per cent of corporation tax receipts was accounted for by ten taxpayers.[10] This is, as continues to be discussed on other reports and fora, a systemically concentrated tax base: it would not be wise to place strategic reliance on this revenue to meet our future needs. The carbon transition will also exert pressure. For example, some €4 billion of carbon-related consumption tax revenues are currently at risk as the carbon transition rolls out.[11] Alongside, the Commission was conscious that, while it was not for it to opine on the optimal scale of State action, expectations as regards the size of the State are changing, including following the pandemic and in relation to the environment and housing market, and this was likely to put pressure on the taxation and welfare systems. Finally, and in using the notion of "strategic foresight", and related anticipatory governance tools, we saw a wider picture of significant uncertainty emerge. The Report identifies the "mega trends" that are likely to influence policy in decades to come, including technological change, demography, and climate. Accordingly, given the changing demographic profile and other fiscal risks, particularly concentration risk in the tax base, and attentive to an uncertain policy setting into the future, the Commission was convinced of the need to prepare for significant and structural change and relatedly of the need to revise the taxation and welfare systems to secure their sustainability.

With this work of the Commission as a frame, I offer three reflections on Barra's paper and, reflecting Patrick's leadership in this area, on the process of tax reform generally.

[6] As outlined at pp. 60-63 of the Report.
[7] As outlined at pp. 64-65 of the Report.
[8] It has surged from €4 billion or so in 2013.
[9] Revenue Commissioners. Headline Results 2023. Infographic (2023).
[10] Department of Finance, Corporation Tax. Tax Strategy Group – 24/03 (2024).
[11] As outlined at pp. 63-64 of the Report.

III REVIEW, DATA AND STRATEGIC ORIENTATION

It is a modest observation, to be sure, but it bears repeating: stand-back reviews, like the CoTW review, matter. Barra's paper underlines how much in fiscal policy and related research remains sticky, contested, and unclear. It also bears repeating how difficult related policy formation is. Taxation and welfare systems are, by their nature, highly dynamic. Through the annual budget cycle, and as the economy evolves, tax measures and reliefs are adjusted, as are welfare rates. This evolution happens in a dynamic, noisy, and contested political and societal space. And so it should. Taxation and welfare policies engage fundamental political choices and constitute some of the most significant and regular touchpoints between people and State. They also form part of the wider social contract[12] – regarded, in general terms and as a proxy, by the Commission, as the rights and mutual obligations that come with living in Ireland. As I stated in the foreword to the Report, they represent the obligations that we owe to each other, and the protections we provide for each other – a notion that can be captured through the notion of "reciprocity." Taxation and welfare policies have therefore historically been at the heart of democratic debate in Ireland, and the annual budget process remains a key feature of the political system. But as a result, related policy is adaptive. It shifts regularly and incrementally, but not necessarily in a strategic manner. It is not easy, in the annual budgetary process, to think long-term, interrogate data, and reflect on scholarly and policy thinking. So it is of acute importance that stand-back reviews that allow space for sustained and informed reflection, are conducted.

In our case, the vehicle for review was an expert group, constituted and mandated by government, following a Programme for Government commitment.[13] The recent use of "citizen assemblies" in Ireland has attracted considerable scholarly attention, certainly in the legal community, in Ireland and internationally.[14] The use of expert groups or commissions has, however, long been part of the institutional architecture supporting policy review and development in Ireland and is just as worthy of research. The CoTW followed most recently, as regards taxation, the work of the financial-crisis-era 2009 Commission on Taxation (whose legacies include the Local Property Tax). It similarly built on the magisterial work of the 1980s Commission on Taxation (which led to the introduction of the self-

[12] For a recent consideration see Shafik, M., 2021. *What we Owe Each Other: A New Social Contract for a Better Society*. Princeton University Press.

[13] *Programme for Government: Our Shared Future* (2020).

[14] See, e.g. Doyle, O. and Walsh, R., 2022. "Constitutional Amendment and Public Will Formation: Deliberative Mini-Publics as a Tool for Consensus Democracy", *International Journal of Constitutional Law* 398; and de Búrca, G., 2020. "An EU Citizens' Assembly on Refugee Law and Policy", *German Law Journal.*

assessment system for the self-employed),[15] the context for which work was interrogated by Patrick in a leading assessment.[16] We were the second Commission to address welfare (since the 1986 Commission on Social Welfare).

All these different commissions were, of course, established in different political, economic, and societal contexts, were mandated with different terms of reference, and developed their own bespoke operating models. But they all reflect a familiarity across the political and stakeholder community in Ireland with such commissions as a vehicle for developing policy, as well as a broader willingness to engage in deliberative processes and consult with civil society and social partners in policy development. They also reflect support for large-scale, synoptic, system-level analysis.

The picture is different in the UK. Commissions of varying hue have long been part of the UK institutional setting. The Royal Commission established in 1832 in relation to the Poor Laws was a landmark in this respect. But Royal Commissions are now rarely used, something which is a matter of debate.[17] The last such Commission on taxation in the UK was the Royal Commission on the Taxation of Profits and Income, which sat for three years over 1950-1953 and prompted a somewhat ambiguous review: "the student of public finance has a many course feast which is likely to prove a strain on his digestion for years to come".[18] We were, I hope, somewhat more digestible.

Expert groups, of different design, remain influential. Key interventions include the influential Institute for Fiscal Studies *Tax by Design* study (the Mirrlees Review)[19] and, recently, the work of the Wealth Commission on a UK wealth tax.[20] But major stand-back reviews, constituted by government as a tool for policy interrogation and development, are now rare,[21] despite their capacity-building potential in the area of fiscal policy.[22] The strong tradition in Ireland of deploying commissions to examine live issues of public policy merits protection.

[15] On the five reports of the 1982-1986 Commission which together are regarded as a seminal examination of the taxation system in Ireland, see, e.g. O'Toole, F., (1993). 'Tax Reform since the Commission on Taxation' XXVI *Journal of the Statistical and Social Inquiry Society of Ireland* 85.

[16] Honohan, P., (1992). 'Fiscal Adjustment in Ireland in the 1980s', *The Economic and Social Review* 285.

[17] The Royal Commission on the Reform of the House of Lords (1999) is one of last such Commissions; only three were set up in the 1990s. See Newson, N., (2020). *Royal Commissions: Making a Comeback*, House of Lords, Library Briefing.

[18] Prest, A.R., (1956). 'The Royal Commission on the Taxation of Profits and Income' (No 92) *Economica*. New Series 366.

[19] Institute for Fiscal Studies (IFS), 2011. Tax by Design, *The Mirrlees Review*; and IFS, 2010. *Dimensions of Tax Design.*

[20] Advani, A., Chamberlain, E. and Summers, A., 2020. *A Wealth Tax for the UK.*

[21] The Royal Commission on the Reform of the House of Lords (1999) is one of last such Commissions. See Newson (2020).

[22] Institute for Government, *Overcoming the Barriers to Tax Reform* (2020).

My second reflection relates to the paper's identification of a data gap as regards how taxation and transfer measures shape incentives. The CoTW adopted an evidence-based approach, drawing data from Irish sources, OECD/Commission datasets and academic papers, as well as from proprietary datasets constructed by the CoTW secretariat. And I would like to acknowledge the now very significant data capacity in Ireland, and the transformation in the data ecosystem since the work of the 1980s Commission on Taxation, from which our work benefited. The leadership of the Foundation for Fiscal Studies has been pivotal in this regard.

Nonetheless, one of the threads running through the Report is the need for enhanced data collection on the operation in practice of the taxation and welfare systems. This is particularly the case as regards the operation of tax reliefs. There are significant data gaps on, for example, the scale of pension reliefs and the profile of capital tax relief beneficiaries. And without data there can be a sort of inbuilt conservativism as regards reform. It is hard (and not advisable) to make the radical reform proposals that a policy setting may demand without the scaffolding of clear data. As has been well canvassed, one of the most contested issues in taxation policy at present is the treatment of wealth and the utility of discrete net wealth taxes. The UK debate, while as contested and noisy as anywhere, has the benefit of being informed by rich data on high earners, made available through the HMRC datalab.[23]

We accordingly addressed data in our Report, and recommended the greater use of partnerships in the production of research, through use of anonymised datasets to support public interest research. We also recommended ongoing support for research in the areas of distribution of income and wealth, the effects of taxation and welfare policy, and the development of improved tools for ex ante evaluation and impact assessment of policy changes. Similarly, on tax system reform more generally, we made a series of recommendations around tax expenditures, including ensuring adequate evaluation data are collected (we called for urgent review of the extent of data availability on pensions); the continued use of sunset clauses for the review of all new expenditures – and we also recommended retrospective sunset clauses for existing ones; and a strengthening ex ante evaluation of expenditures before their introduction.

Finally, Barra's paper is striking in charting the longitudinal shifts in the nature and size of the fiscal state, building on Patrick's pioneering work. These shifts and changes need to be embedded in reform discussions and their implications understood. The CoTW relatedly made a series of recommendations on strategic reform. These include that government departments build on existing long-term fiscal analysis capabilities to build a system of scenario modelling and stress-testing which would examine different future public finance scenarios and how well the State could react; and examine whether there are adequate policy tools and administrative systems in place to address potential outcomes.

[23] On the value of the HMRC datalab see Summers, A. *Written Submission to Parliament* (Finance Bill) (DFH0004).

An institutional attentiveness to confronting difficult questions and to ensuring related data gathering and interrogation in the policy formation process is essential if fiscal policy is to serve the public interest over the medium and long term. Patrick's pioneering work continues to provide important lessons in this regard.