Ibec
For Irish Business

Ibec priorities for Budget 2017

Compete to succeed

“Budget 2017 must deliver a major overhaul of our business and personal tax offering. We need to stay competitive and keep business costs under control.”

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What Budget 2017 needs to do for Ireland and for Irish business

Since the UK vote to leave the EU, developments have been rapid and dramatic. The outcome has convulsed British politics, significantly increased economic uncertainty and will dominate the domestic and EU agenda for years. The task now is to ensure Irish interests are protected and advanced as we move towards formal exit negotiations.

Ireland has a unique economic relationship with the UK and Ibec is working domestically, in the UK and at EU level to ensure this is fully appreciated from the outset. But we need to do much more. We need to re-position Ireland for the challenges, opportunities and uncertainties ahead.

Ibec has long highlighted the competitive threat from the UK's increasingly pro-business tax regime; Ireland needs to take heed. UK plans to further cut corporation tax to shore up their attractiveness as an investment location is an early, but unsurprising indication of the post-Brexit political and economic reality. This new reality needs to be reflected in government policy.

Budget 2017 must deliver a major overhaul of our business and personal tax offering. Yes we need to cooperate with the UK on areas of mutual interest, but we also must compete aggressively in areas where we need to stay ahead. We need to stay competitive and keep business costs under control.

We also need to be ambitious. Ireland has the potential to continue to grow strongly in the years ahead, but we need to think big and plan for the future. Ambitious investment is needed to improve the capacity of the economy and overcome worrying infrastructure bottlenecks.

Ireland can overcome current challenges, but there is no room for complacency and heightened uncertainty is likely to remain a feature of economic life in Europe for some time. This submission sets out in detail how the upcoming budget should respond to the vote and plan for future success.

Danny McCoy
Ibec CEO

Budget 2017
Ibec key messages

1 Stay the course on fiscal policy

While it is important that the Government does not overreact in framing Budget 2017, Ireland's strategic interests must be prioritised while the post Brexit scenario remains highly fluid. This should involve policy choices which will solve strategic supply side problems and protect those industries most likely to be adversely affected by the immediate volatility. **The Government should not deviate from plans for a modestly expansionary budget for 2017.** This would include budget day measures totalling €1 billion and seeking derogation from the EU to invest a further €1 billion in social housing outside the current fiscal rules.

2 Send a positive signal through wise investment

Through investment in crucial economic and social capacity at home, Budget 2017 can send a message of confidence to the world during this period of uncertainty. In previous crises the first budget item to go was capital. This simply cannot be repeated if the scope for future discretionary spending diminishes. Given the low carry costs of debt, strong nominal growth rates, a primary surplus, and considerable infrastructure gaps, investment can be achieved while reducing the deficit in the prudent manner. **Certain investments – not least those in housing – can replace inefficient recurrent spending with capital solutions. This will prove more effective and cost efficient over the longer term.**

In the context of Brexit, there is now an increased urgency for the Government to negotiate flexibility in the application of EU fiscal rules which currently place inappropriate and unnecessary restrictions on investment. Irish business supports a pragmatic, rules-based approach to the management of day-to-day spending and taxation. However, spending on vital capital investment projects should be treated in a manner more akin to that which obtains in the private sector.

3 Create a level playing field with the UK for SMEs

A major objective of the upcoming budget must be the provision of support to those industries for which the immediate fall-out from Brexit is greatest. These include some of our largest employers – the SME community, manufacturing and tourism in particular. Helping these sectors maintain a competitive edge will be an important factor in overcoming the challenges that Brexit will pose. **The Government must ensure that enterprises do not face any regulatory, labour cost or tax increases while the current period of uncertainty and exchange rate volatility persists.** In addition, potential trade restrictions post Brexit and the more preferable tax treatment of SMEs in the UK raise the possibility of Irish SMEs servicing that market from within the UK itself rather than by exporting from Ireland. As such, the need to level the playing field in relation to the tax offering for indigenous business has never been more urgent. We show that this can be achieved by radically reforming our entrepreneurs' CGT regime, along with improving our incentives for investment, innovation and up skilling in SMEs.

4 Align economic and social priorities through housing

In Budget 2017 the Government should seek a temporary derogation from the European Commission to spend €1 billion outside the fiscal rules in delivering an additional programme of social housing beginning in 2017. It should also introduce a new model of social housing provision based on that of the Northern Irish Housing Executive. In this submission, Ibec outlines proposals for a number of reforms in the housing sector which will better serve our requirements over the long term.

5 Give Ireland an edge for highly skilled workers

While Brexit is not the outcome Ireland would have wished for, Ireland remains well positioned to benefit from new investment opportunities. Since the advent of the OECD base erosion and profit shifting (BEPS) project, Ibec has drawn attention to the changing global environment where capital is following highly skilled labour. The positioning of Ireland in a post-Brexit world may mean an acceleration of this trend as multinationals, and not just those in financial services, look for an attractive home within the EU. Along with investment decisions, which will affect standards of living, including housing, access to education and public infrastructure, **Budget 2017 must address key tax issues – particularly the treatment of share options – which currently make Ireland a less attractive location for more highly skilled workers.**

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> "This year Ireland's economy will continue to perform strongly on the back of the very positive first half of 2016."

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Investment

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The economic context and the fiscal space

The upcoming budget will be introduced in the shadow of a UK political decision which will have significant implications for Ireland and Europe over the medium to long term. Exchange rate volatility aside, as of now, little has changed in the Ireland-UK trading relationship. This year Ireland's economy will still perform strongly on the back of the very positive first half of the year. We expect growth to remain in excess of 4% during 2016.

Expectations of a slowdown have emerged in the UK as businesses and consumers re-evaluate their position. While this means that the outlook for 2017 is now considerably more uncertain, it is still too early to tell what the full effect of Brexit will be, either domestically or internationally. This depends as much on the ability of the political system in the UK to engender confidence in consumers and business over the coming months as on any external factor.

Ireland is in a better position to weather the uncertainty of Brexit now than it has been over previous years. Our fiscal position has improved rapidly with debt ratios now reaching developed world norms and the State reaching a primary fiscal surplus in 2015. Given that the average interest rate on our outstanding government debt (3%) is lower than expected nominal growth rates of GDP, both the debt ratio and the relative cost of debt servicing should fall significantly over the coming years.

In a post EU Fiscal Compact world, limits on spending and tax decisions will be much more explicit and binding than in the past. This means that much more strategic choices have to be made in the future in relation to resource allocation. Ibec's budget submission takes the view that in the current economic climate these resources are best focused on strategic priorities which expand the productive capacity of the economy – capital investment, housing, tax reform, education and innovation. This does not mean social goals must lose out. In many cases outlined in this submission – including capital investment, housing, education, training, childcare, share options and innovation – the two are aligned.

In its most recent Summer Economic Statement, the Government presented a gross fiscal space of €1.8 billion in 2017. This means that in nominal terms, government spending or tax cuts can amount in total to €1.8 billion in the absence of offsetting measures. From this the Department of Finance estimates that the State will need to spend almost €400 million to allow for demographic pressures in health, education and pensions – a further €300 million has been committed to public sector pay under the Lansdowne Road agreement. While at the time of writing the Department of Finance has confirmed the 2017 fiscal space will remain unaffected by Brexit, its impact on future years will be far more uncertain.

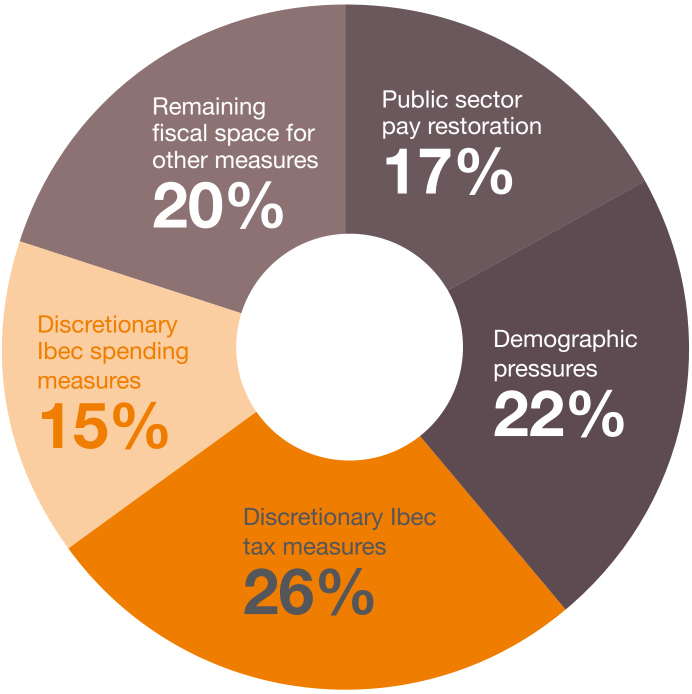
Table 1: Gross fiscal space and Ibec measures

	Tax	Expenditure	Fiscal rules derogation	Total	Fiscal space remaining
Gross fiscal space	–	–	–	–	1,800
Spending pressures, of which:					
Lansdowne road	0	300	0	300	1,500
Demographic pressures	0	400	0	400	1,100
Total pre-existing spending pressures	**0**	**700**	**0**	**700**	**–**
Discretionary Ibec measures, of which:					
Personal tax	277	0	0	277	823
Consumer tax	50	0	0	50	773
Entrepreneurship and business tax	136	10	0	136	637
Investment	0	100	0	100	527
Housing	6	0	1,000	1,006	521
Skills, innovation and labour force participation	0	172	0	172	349
Total Ibec fiscal space measures	**469**	**282**	**0**	**741**	
Remaining fiscal space for other measures	–	–	–	–	349

The Fiscal Advisory Council (IFAC) has reviewed this estimate and noted a number of things – not least that the estimates assumed no price push inflation in public sector spend or welfare payments, that it left no allowance for a successor to the Lansdowne Road Agreement post 2018 and that forecast demographic and spending pressure estimates are short of what will be needed to keep up with population pressure. IFAC estimates that around €10 billion of the total 2017 to 2021 fiscal resources of over €14.7 billion will be taken up by non-policy related spending pressure. This was a near €6 billion higher than the Department of Finance estimate of €4.5 billion.

Neither estimate takes into account indexation of the personal tax system – without which we face tax increases in real terms. For the personal tax system this would cost in the region of another €2 billion between 2017 and 2021. In total, keeping the tax and spending system at a standstill would cost up to 80% of the available additional resources over the coming years with the remainder left for tax measures or spending increases. In short, money will be tight. As such, a number of our priorities in this submission strive to either provide targeted solutions to pressing issues or to use existing resources in a more effective manner.

Figure 1: Use of gross fiscal space



Taxation

2.1 Personal taxation

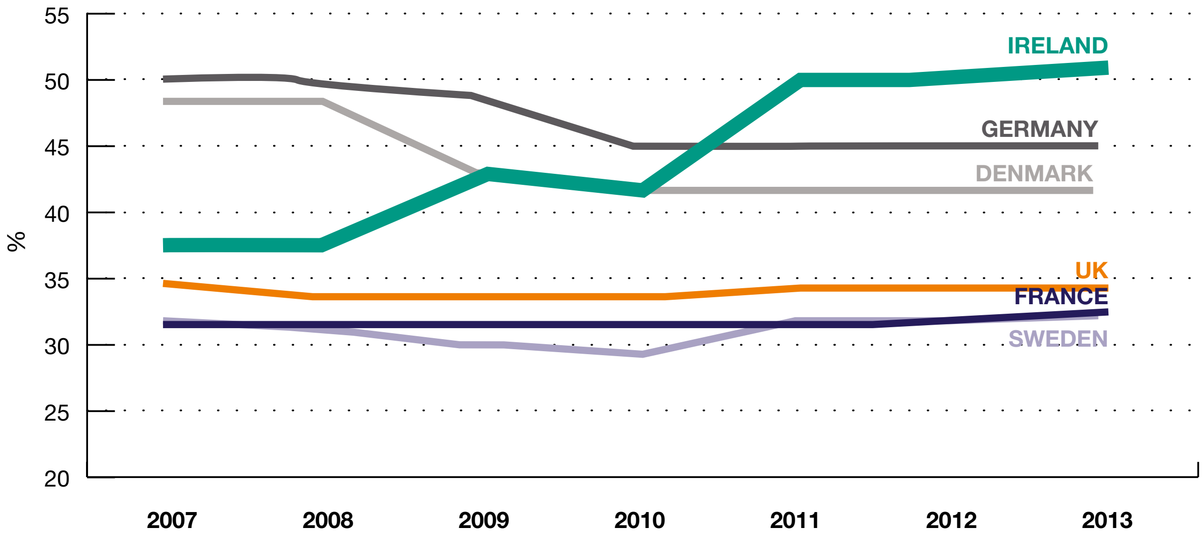
Ireland has an income tax system which looks like that of no other developed economy. This system is characterised by a narrow base and both very low and very high effective tax rates at each end of the income distribution. More workers in Ireland pay no income tax at all than any comparable country while, conversely, 50% of workers face losing 49.5c out of every €1 they get in a pay rise. This represents the worst of both worlds when it comes to building an efficient tax system.

Ibec supports the international evidence which shows tax systems with a broad base and low marginal rates provide the best outcomes for employers, employees and the economy. The following sections outline our recommendations for how steps towards this can be achieved in Budget 2017.

Issue 1: Entry point to the marginal rate of tax

Ireland has one of the highest marginal tax rates in Europe. What is particularly damaging is that this rate kicks in at a level which is much lower than in any other European country. Comparative figures from the ESRI and the UK's Institute for Fiscal Studies show that while less than 20% of UK workers face losing more than 50c from a €1 pay increase in tax and benefit changes; the same figure in Ireland is more than double that. These high losses are a barrier to labour market participation in particular for second earners whose labour market decisions are much more sensitive to tax and benefit changes.

Figure 2: Median loss from a €1 pay increase through tax and benefit changes (%)



Source: Euromod tax benefit model

Ibec recommends

Irish workers currently hit the 49.5% rate of tax at less than the average wage, which is €36,500. The same figure for the 40% rate in the UK is now equivalent to €55,000. This is partly a result of their longstanding policy of automatic indexation of tax bands. In a similar fashion, Budget 2017 should see the entry point to the top rate of tax indexed to the rate of wage growth in the economy.

How Ireland will benefit

Half of Irish employees pay at the marginal tax rate handing over half of the benefits of any pay increase to the exchequer. Indexing the entry point to the top rate of tax to wage growth will prevent more employees from falling into the top rate over the coming years. This will make it easier for employers to give pay increases, increase real incomes for average earners and prevent Ireland's labour market from suffering from fiscal drag. Failure to do so would represent a tax increase in real terms.

Exchequer cost/benefit

Given employment and wage developments, full indexation of the top rate entry point to wages would cost in the region of €170 million in 2017.

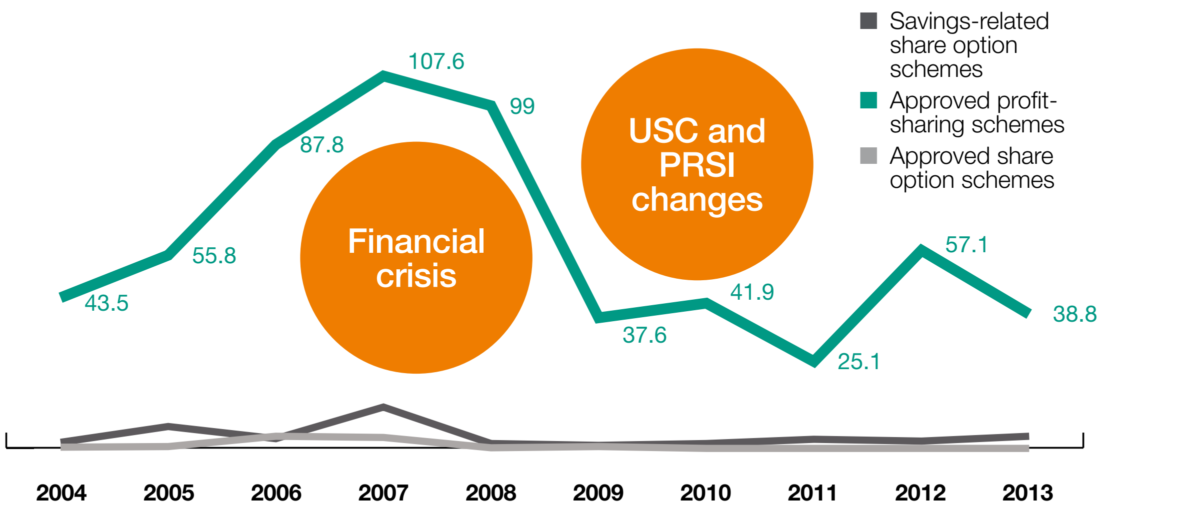
2

Issue 2: Taxation of stock options

Share-option and profit sharing schemes can be a very important way for companies to reward and retain key employees. They also have proven benefits in rewarding key staff and generating higher productivity through employee buy-in. These benefits accrue to both firms and employees alike. A number of issues have arisen which have reduced the attractiveness of such schemes in comparison to less economically advantageous forms of incentivisation, namely:

- It has become more difficult for companies to implement revenue-approved schemes in a manner which links rewards to individual performance.
- The tax liability on unrealised gains makes the use of stock options unattractive. The unusual structure of Ireland's income tax system means that our effective rate of tax for stock options for average earners, at 52%, is almost 26.5 percentage points higher than if UK tax rates were applied under the same rules.
- The introduction of USC and PRSI on revenue-approved schemes along with increased CGT rates precipitated a major drop off in participation.
- The high fixed costs and disadvantageous treatment of stock options in Ireland is a major obstacle to small firms attracting high quality management.

Figure 3: Tax expenditure by share option scheme



Source: Revenue Commissioners

Ibec recommends

In line with our recent submission to the consultation on the taxation on stock options, Ibec has a number of recommendations:

1. Reform of the operational constraints in revenue-approved schemes to be more flexible to companies' reward structures.
2. Reduction of the income tax liability on unapproved schemes to the ordinary rate of tax along with averaging it out over five years.
3. Removal of the USC and PRSI liability from revenue-approved schemes.
4. Introduction of an enterprise management incentive scheme for smaller firms.

How Ireland will benefit

These steps would encourage greater use of employee share ownership in Ireland which until now has been comparatively low and falling. The 2014 review by the European Commission's DG Internal Market concluded comprehensively that "thirty years of research have confirmed that companies partly or entirely owned by their employees are more profitable, create more jobs and pay more taxes than their competitors". There are also clear benefits from an employee point of view – the 2015 report of the Commission on Inclusive Prosperity, chaired by Larry Summers and Ed Balls, argued that profit sharing and employee share ownership were win-win policies given that they benefit employees at the same time as producing better outcomes for business.

Exchequer cost/benefit

The current cost of tax expenditure on revenue-approved schemes is just over €42 million per annum. We estimate that removal of the USC and PRSI liabilities on revenue-approved schemes would cost in the region of €8 million. In addition, the reductions for non-approved schemes would cost in the region of €20 million in total tax forgone with the remaining €40 million being spread over five years. The total budget cost in 2017 would be €52 million but €32 million would be recouped over the following years in staggered payments. Based on the EMI scheme experience in the UK there would be no immediate budget cost but the scheme would cost between €1 and €5 million per annum in future years. Finally, the uplift from increased participation in approved schemes from reduced operational constraints would cost in the region of €20 million in 2017 over and above what would otherwise be the case. The total 2017 cost of our proposals would be in the region of €80 million.

> "Thirty years of research have confirmed that companies partly or entirely owned by their employees are more profitable, create more jobs and pay more taxes than their competitors"

3

Issue 3: Private sector pensions

Private sector pension coverage in Ireland is relatively low by international standards. According to the latest OECD figures, only 41.3% of workers are enrolled in a funded pension plan. In addition, this varies dramatically across different sectors and types of workers. Steps must be taken to improve our record in this space.

Ibec recommends

Budget 2017 should see an increase in the standard fund threshold (SFT) for pensions from €2 million to €2.15 million and an increase in the earnings limit on tax relief from €115,000 to €125,000. There should be a commitment to indexation of these two measures to wages in future years.

How Ireland will benefit

Ireland's record of pension coverage is demonstrably poor. In addition, recent years have seen the attractiveness of pensions reduce significantly as a result of a number of tax changes. It was the long-term practice that the tax treatment of pensions was indexed to wages. Since the reduction in the SFT in 2010 this has ceased. Given the return to wage growth in the economy this practice must return in Budget 2017 and future budgets.

Exchequer cost/benefit

An increase in the earnings limit by €10,000 would cost in the region of €25 million. The reduction in the SFT from €5 million to €2.3 million in 2010 brought in the region of €20 million to the exchequer. On a pro-rata basis, and adjusting for total wages growth in the interim, we estimate increasing the SFT to €2.3 million would cost in the region of €2 million in 2017.

4

Issue 4: Tax credit removal for higher earners

In recent times the Government has taken steps to reduce the 'gains' from income tax reductions for higher earners by creating a third rate of tax for those earning more than €70,000. The new Government has committed to continue this line of policy by phasing out personal tax credits for higher earners, in part to pay for the abolition of the USC and further narrowing of the tax base. An analysis of similar tax changes in the UK by both HMRC and the Office for Budgetary Responsibility concluded that the Exchequer net benefit was little or nothing.

Ibec recommends

Using this policy lever in order to pay for the USC may work in a static analysis but it is unlikely to raise much money and will further damage companies' ability to attract and retain highly skilled employees. No action should be taken in Budget 2017.

How Ireland will benefit

Ireland, despite being an outlier in terms of its low taxation on low income earners, surpasses the OECD average effective income tax rate at earnings of 120% of the average wage or just above €39,000. By 250% of average wage (€81,500) Ireland has the sixth highest average income tax rate in the OECD at 34.6%, five percentage points higher than the OECD average. Recent research in Denmark has provided clear evidence that mobile skilled workers are affected by marginal tax rates at the top of the earnings distribution (Kleven, et al, 2013). These high marginal and effective rates for similar workers in Ireland are making it increasingly difficult for companies to attract and retain highly skilled staff. If Ireland gets a reputation for an inability to deliver projects because of this, the negative implications for investment would be difficult to reverse.

Exchequer cost/benefit

Cost neutral.

2.2 Consumer taxation

5 Issue 5: Taxation of sugar

A “health levy on sugar sweetened drinks” has been proposed. This would effectively be an additional tax on soft drinks, to which VAT already applies. Various projections have suggested that the tax could generate up to €120 million per year while advocates contend it will cut obesity and related diseases through reducing consumption of soft drinks. These two views are mutually exclusive.

In addition to Ibec’s opposition to the principle of discriminatory taxation on particular types of food and drink products, we point to overwhelming international evidence that no sustained reduction in consumption of soft drinks is achieved through a so-called sugar tax. Furthermore, the likely increase in cross-border trade and black/grey market trade in these products which would inevitably result from price hikes caused by additional tax will cause damage to Irish businesses as well as making the tax-take highly unstable.

Ibec recommends

No additional tax on soft drinks. Focus should be made on public health measures of proven efficacy such as product reformulation.

How Ireland will benefit

Jobs in the soft drinks sector will be protected and trade will not be lost across the border to Northern Ireland or to the grey/black market. Soft drinks companies will continue to invest in research and development on reformulation and new products which has far greater impact on public health than even the most optimistic projected impact of a soft drinks tax.

Exchequer cost/benefit

Cost neutral.

> “We point to overwhelming international evidence that no sustained reduction in consumption of soft drinks is achieved through a so-called sugar tax.”

6

Issue 6: Alcohol excise

Excise on alcohol has been increased substantially in recent budgets including a full-year effect of €180 million in 2013 and a further €145 million in 2014. These excise increases have created a hostile domestic environment for this growing domestic sector, putting pressure in particular on the cash-flow of SMEs and acting as a deterrent for investment among larger firms. In 2015 the exchequer received over €2 billion from taxation on alcohol. Sharp increases in excise levels in recent years have pushed Irish alcohol prices up and they are now the most expensive in Europe. Irish alcohol prices are now 75% above the EU average and are over twice as high as similar prices in countries such as France, Germany and Spain. The majority of this difference is driven by tax differentials.

Source: WHO 2015, Eurostat 2015

Ibec recommends

Irish excise taxes are among the highest in the developed world. It is unlikely that further excise increases will either significantly increase revenue or moderate consumption given the complicated and non-linear relationship between the two. If anything, Brexit may mean further excise increases will drive cross-border trade. The path toward reducing recent excise increases should begin in Budget 2017.

How Ireland will benefit

Excise is a doubly regressive tax in that it is charged regardless of income and it targets goods which are consumed in much greater quantities by lower income households. Ireland already has the highest alcohol prices in Europe and it is unlikely that increasing excise will raise significant further sums. In addition, alcohol use has fallen significantly in the past decade with further increases unlikely to change this but rather increase illicit trade.

Exchequer cost/benefit

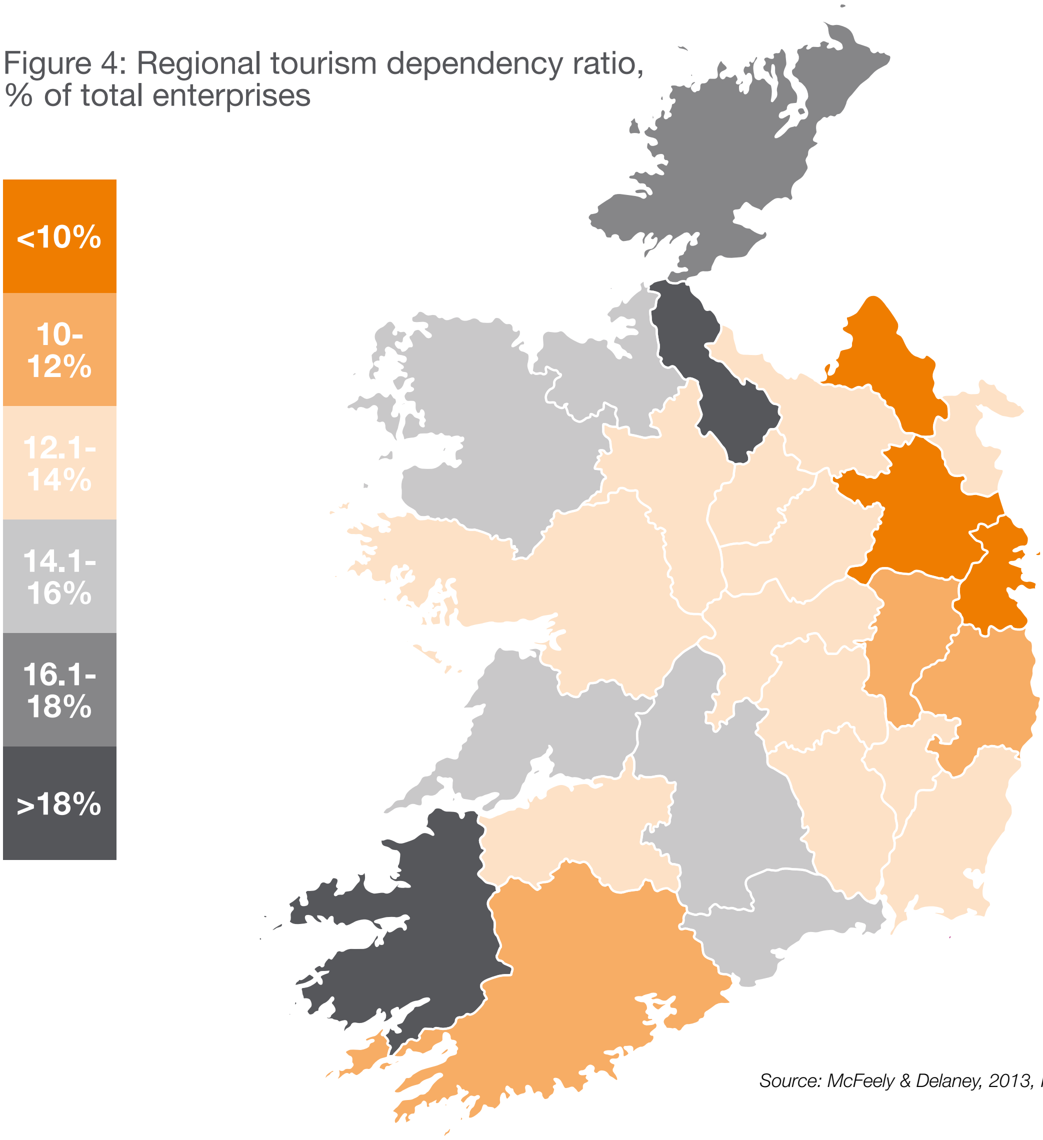
€50 million.

"Sharp increases in excise levels in recent years have pushed Irish alcohol prices up and they are now the most expensive in Europe."

Issue 7: The 9% tourism VAT rate

As part of the Jobs Initiative announced in May 2011, a new 9% rate of VAT on selected categories of largely hospitality goods and services was introduced for a temporary period running from July 2011 to December 2013. This scheme has since been extended. Various analyses of the employment and exchequer impact of these measures showed that they had been very successful and have delivered strong employment gains and retention and substantial return for the exchequer. This industry is now at substantial risk given the implications of Brexit for current exchange rates and freedom of movement in the longer term.

Figure 4: Regional tourism dependency ratio, % of total enterprises



Source: McFeely & Delaney, 2013, Ibec calculations

Ibec recommends

The 9% VAT rate should be retained as a permanent feature of the tax system. The tourism sector will need more support to ease it through a period which is likely to be particularly volatile.

How Ireland will benefit

The 9% VAT rate is a crucial support for an exporting industry which provides strong regional employment and is increasingly facing higher cost and competitiveness pressures from elsewhere.

Exchequer cost/benefit

Cost neutral.

8

Issue 8: Tobacco excise

Ireland has the second highest level of tobacco prices in the EU. Recent years' experience has shown that expected revenues from these increases have not materialised and suggest that further increases will be a victim of diminishing marginal returns. A cumulative increase of €1 per packet in excise between 2011 and 2015 has seen actual yields fall by 11% rather than the tens of millions in expected returns. These expected returns were, however, built into the current budget. Two Revenue Commissioners' studies (2011, 2015) of the tobacco market drew attention to this. They concluded that further increases in tobacco excise would move it beyond a "critical point at which increases in tax rates lead to lower, rather than higher, tax revenue. Further tax rises will reduce smoking somewhat but they will also greatly encourage more untaxed consumption". While the level of non-Irish duty paid tobacco has stabilised in recent years, it still represents approximately 18% of all tobacco consumed in Ireland. With well-established distribution channels, and criminal links, continued excise increases have the real potential to further exacerbate its growth.

Ibec recommends

No change in tobacco excise in 2017.

How Ireland will benefit

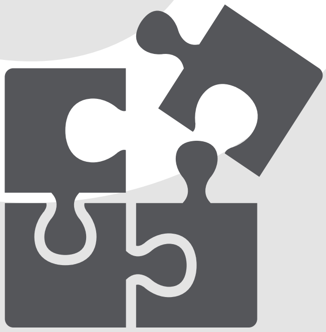
Irish tobacco excise is now beyond the point of diminishing marginal returns. Solid research and recent experience have suggested increasing it further will be at a cost rather than a benefit to the exchequer. Budgeting current spending increases based on increases in tobacco excise would represent wishful thinking at best.

Exchequer cost/benefit

Cost neutral.

> "A cumulative increase of €1 per packet in excise between 2011 and 2015 has seen actual yields fall by 11% rather than the tens of millions in expected returns."

Business and entrepreneurship



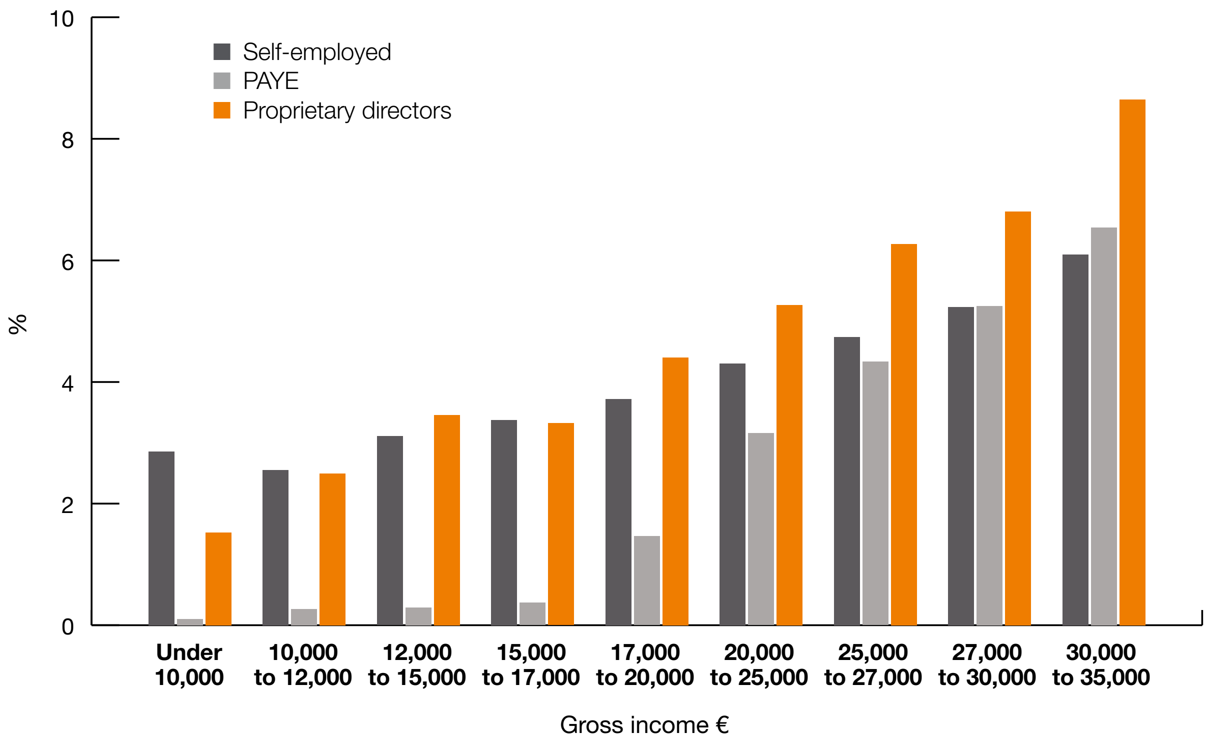
Taxation of entrepreneurs and small business is an issue which has received a lot of warranted attention in recent times. Over the past decade, policymakers across the board have lauded entrepreneurs as being central to developing indigenous firms which can compete globally. The signals we send through our tax system, however, differ greatly from the rhetoric. Improvements were made in Budget 2016 but the new Government must build on these in the upcoming Budget.

Commitments need to be followed through; with changes to taxation the single biggest step the Government can make to encourage more people to go into business for themselves. With the higher rate of USC for the self-employed and the higher rates of CGT introduced in recent years, our tax system has gone in the opposite direction to much of enterprise policy. If we are truly serious about creating a highly-skilled entrepreneurial economy the level of recognition which has been given to the issue needs to be backed by action.

9 Issue 9: Taxation of the self-employed

The PAYE tax credit in effect allows an individual to earn €8,250 free from income tax. The lack of a PAYE tax credit equivalent for self-employed persons or proprietary directors means their effective income tax rates are much higher than PAYE workers at the same income level.

Figure 5: Actual effective tax rates of lower than average incomes



Source: Revenue Commissioners

Even with tax reliefs available to self-employed persons accounted for, self-employed and proprietary directors at less than average incomes have much higher effective tax rates than PAYE workers. This is a particular issue when building a business in Ireland.

Ibec recommends

The lack of an equivalent earning income tax credit (EITC) for the self-employed is not supported on any reasonable basis. The Government should commit to rectifying this situation over the medium-term. The Government should extend the modest EITC for self-employed persons in Budget 2017.

How Ireland will benefit

Entrepreneurs play a crucial role in the Irish economy. The Irish tax system, which today sends very mixed signals to entrepreneurs, must transition toward one which champions entrepreneurship. To achieve this, we need to see changes which make it more attractive for people to take on the burden of risk, expand their businesses and invest their time and money in the things which create jobs and wealth. Targeted tax reforms focusing on entrepreneurship can support a more dynamic domestic enterprise base. This applies not only to capital taxes but also to income taxes.

Exchequer cost/benefit

Extending the EITC by €550 in Budget 2017 would cost in the region of €60 million in a full year and €18 million in 2017.

10 Issue 10: CGT entrepreneurs' relief

Some improvements were made to the entrepreneur's relief from capital gains tax in Budget 2016 with the scheme being reformed and simplified. Under the new regime a reduced capital gains tax rate of 20% (up to an overall limit of €1 million) will apply when selling all or part of a business. While this change was welcome it still leaves Irish SMEs at a distinct disadvantage to their UK counterparts where the rate is 10% and lifetime limit £10 million. The UK market is an important one for Irish SMEs across a number of sectors and for many is their main growth market. The prospect of trade restrictions post Brexit and the preferable tax treatment, it will become more attractive for many Irish-based SMEs to expand and service that growth market from within the UK rather than by exporting from Ireland. As such, the need to match these rates has become more urgent than ever.

Ibec recommends

Without significant improvement in the treatment of capital gains relative to the UK, Ireland risks losing high potential SMEs to the UK. This is a particular concern in areas such as manufacturing and agri-food where reliance on the UK market is highest. The commitment in the Programme for Government leaving future changes for start-ups alone would be wholly inadequate in this context. Budget 2017 should see Ireland improve its offering significantly when compared with the UK by increasing the lifetime limit from €1 million to €15 million in Budget 2017 and reducing the rate under the relief to 10%.

How Ireland will benefit

Changes to the CGT entrepreneur's relief in Budget 2016 provided some boost for growing SMEs but they did not go far enough. The outlook for high potential Irish SMEs has changed in a post-Brexit environment and the Government must be aware of that competitive threat.

Exchequer cost/benefit

The cost would be in the region of €52 million in 2017.

"Without significant improvement in the treatment of capital gains relative to the UK, Ireland risks losing high potential SMEs to the UK."

11

Issue 11: Seed Enterprise Investment Scheme (SEIS)

The UK has recognised the differential risk profiles between micro and medium sized enterprises by introducing the SEIS. This scheme provides more generous incentives for individuals investing in start-up firms less than two years old with less than 25 employees and gross assets of less than €200,000. Costing £58.5 million (€81 million) this scheme is targeted at a totally different category of firms than the EIS, namely those very small and micro-firms which are newly formed. In this sense it complements rather than competes with the EIS scheme, where most if not all of the funding tends to go to mid-cap companies.

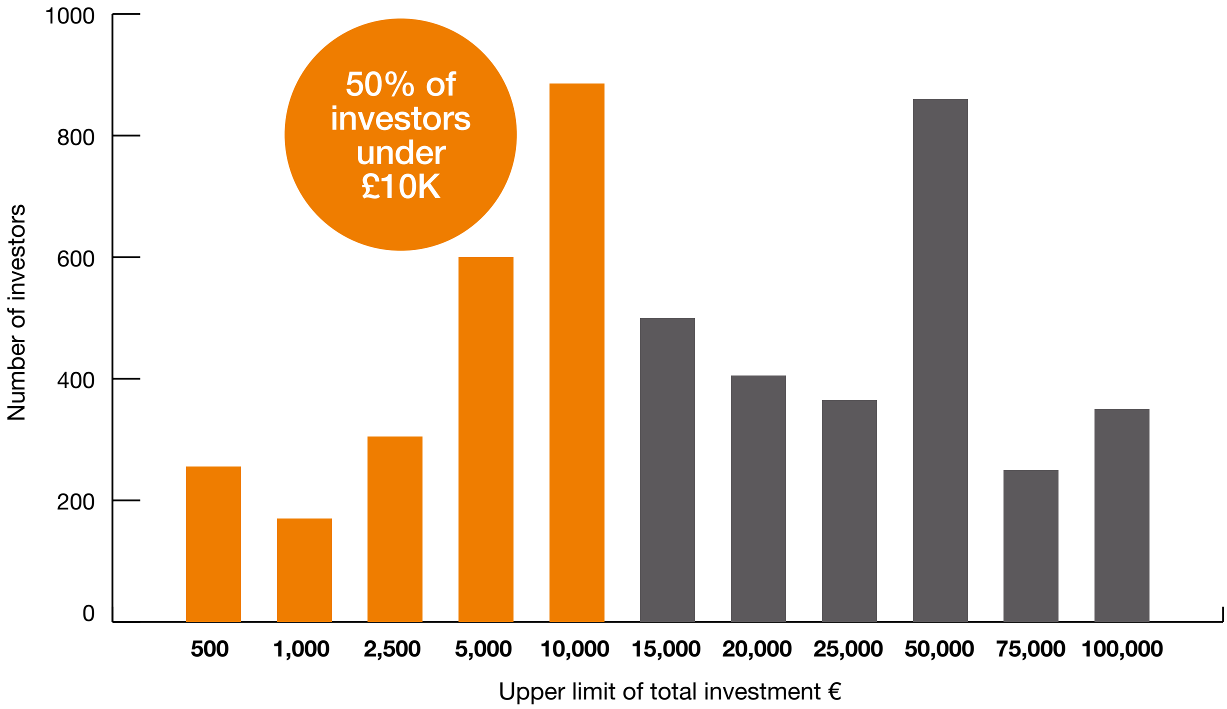
Ibec recommends

An introductory version of the SEIS scheme similar to its UK equivalent would remove a barrier to small start-up businesses, while also encouraging first-time investors into the market. A 50% income tax credit on investments in new or micro-firms on similar terms to the UK scheme should be introduced in Budget 2017.

How Ireland will benefit

The SEIS scheme has the advantage of being more attractive to small-time investors who can invest up to £100,000 in a single tax year over a number of companies. They receive a 50% tax credit on their investment which is sufficiently attractive to bring new investors to small firms with limited avenues of funding half of the investments in the UK were of less than £10,000 showing the scheme's ability to attract non-traditional investors into the market in small sums. This is partly due to the fantastic branding of the scheme and its ease of use. A similar angel investment tax incentive would boost non-traditional financing for start-up firms and micro-enterprises in approved sectors.

Figure 6: SEIS (UK) investor profile



Source: HM Treasury

Exchequer cost/benefit

Extending the EITC by €550 in Budget 2017 would cost in the region of €60 million in a full year and €18 million in 2017.

12

Issue 12: R&D tax credit administration

Previous government reviews of the R&D tax credit scheme have shown that it is very effective in supporting R&D activity and provides a good return on investment for the Irish economy. In order to maximise its impact we recommend that the scheme is amended to enable expenditure relief at 12.5% corporate tax rate to be taken above the line.

Ibec recommends

Previous changes to the legislation which allowed companies to show the credit ‘above the line’ greatly improved the attractiveness of the scheme to many businesses at no extra cost to the exchequer. The change in accounting treatment meant that businesses could use the credit more effectively when competing for mobile R&D projects on a pre-tax assessment basis with other jurisdictions.

The Government should now build on this progress by changing the R&D legislation to provide companies with an option to claim the R&D tax credit at 37.5% ‘above the line’ while foregoing the associated corporate tax deduction at 12.5%. This would lead to a 50% increase in the potential ‘above the line’ credit.

The denial of a corporate tax deduction at 12.5% on qualifying R&D expenditure means that the proposal is a cost neutral one from the exchequer perspective, and will result in the same level of overall tax payable as is presently the case under current legislation.

How Ireland will benefit

Neither change would incur any exchequer cost and would substantially improve the operation of the scheme from a business point of view.

Exchequer cost/benefit

Cost neutral.

“The Government should now build on this progress by changing the R&D legislation to provide companies with an option to claim the R&D tax credit at 37.5% ‘above the line’.

13

Issue 13: R&D tax credit and SMEs

Smaller firms and start-ups in particular face funding constraints for R&D investments. Despite this, the R&D tax credit's take-up among smaller companies has been weak. Only 1% of companies with turnover less than €1 million use the tax credit each year, compared with 12.5% above that mark.

A large part of this is again down to sectors in which they are operating but evidence *(ESRI, 2010)* suggests that foreign owned and internationalised domestic firms are far more likely to invest in innovation and are more likely to translate this investment into tangible gains than domestic facing indigenous Irish firms.

Ibec recommends

The administrative costs associated with the R&D tax credit are too burdensome for smaller firms to participate with the credit. A pro-forma R&D tax credit should be introduced to help smaller firms overcome these costs and engage with the credit.

This would include the use of pro-forma templates for R&D project management, recording R&D activity and calculation of eligible costs and revenue benefit associated with the credit. Simple online calculators demonstrating the benefit and eligibility rules of the credit would be a useful resource for SMEs and would also greatly improve awareness and promotion of the scheme.

How Ireland will benefit

The R&D tax credit has been a successful model in encouraging Irish companies to invest in R&D and create value in the economy. In line with international research, an Ibec study showed that for every €1 given in tax credit to participating firms they spend in the region of an additional €1.25 on R&D over and above what they would otherwise have spent. Recent studies in the UK show this additional expenditure is much larger for SMEs *(Nguyen & Van Reenan, 2016)* at €2.60 while others suggest that it could rise as far as €3.60 in the long-run.

Exchequer cost/benefit

In 2013 (our most recent figures) 30% of the value of the €421 million credit went to small companies, or €126 million. Increasing the value of take-up of the R&D tax credit among small firms by 10% (€12.6 million) could add as much as €45 million to R&D spending across the economy over the long-run.

> "Despite this, the R&D tax credit's take-up among smaller companies has been weak."

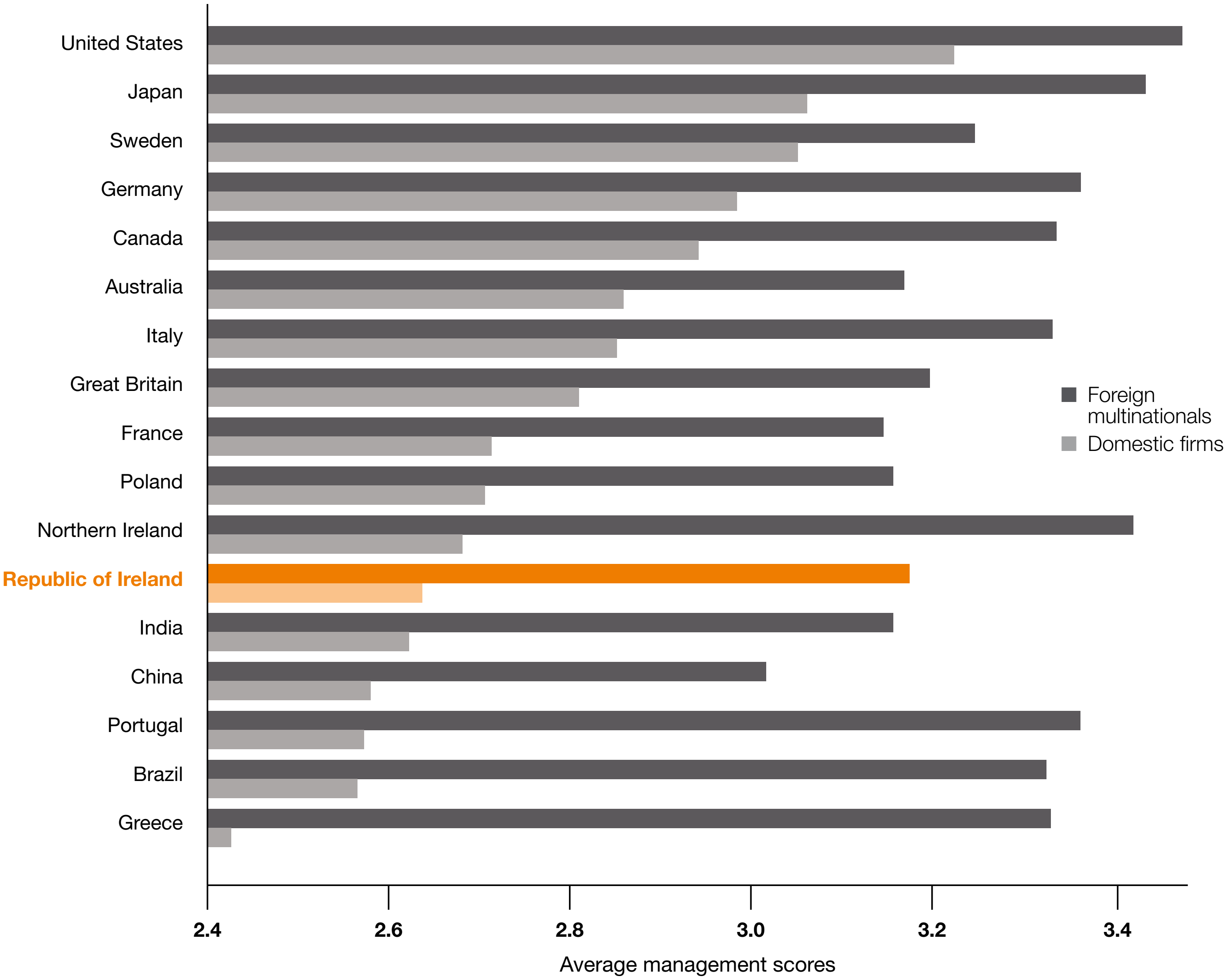
14

Issue 14: Management training incentives

A 2010 study of Irish firms by researchers from the London School of Economics found that firms in Ireland have poor management practices lagging considerably behind their counterparts in the US and UK. They also found that Ireland had a long tail of poorly performing firms which was not seen in other countries. Our overall national performance was then boosted by some very high scoring multinationals. Irish domestic firms in general were 20% behind multinationals in terms of management practices.

Among 10,000 firms in manufacturing and retail across 21 countries, Irish domestic firms and particularly SMEs suffered the biggest challenge with management. Irish indigenous firms were second bottom among developed countries, ahead of Portugal and Greece.

Figure 7: Management scores (0-5) in domestic and multinational companies



Source: Bloom, Genakos, Sadun, and Van Reenen (2009)

Ibec recommends

Incentives for staff in SMEs to take on management training should be extended. A targeted management training incentive aimed at the point of transfer of family business in the first instance should be introduced. This would be achieved by relieving from capital acquisitions tax completely (currently 90%) the transfer of a business where the recipient of the business has taken part in approved management training schemes.

How Ireland will benefit

Management and skills are key components of business growth in any economy. Research has shown internationally that improved management skills can improve sales growth, market share growth and lead to higher productivity. Indeed, recent research (Bloom et al, 2016) shows management skills account for up to 50% of the productivity differential between developed countries and the US.

Exchequer cost/benefit

Business relief at 90% currently costs in the region of €90 million. Increasing this by a further 10 percentage points would cost a further €10 million. Depending on the level of training in order to qualify for the scheme, it is likely it would cost between €1 and €3 million.

15 Issue 15: Town centre regeneration

Many of our regional towns and villages are still struggling with a lack of consumer spending and empty retail units on the main street. Urgent investment is needed to make them more attractive places for consumers and businesses alike.

Ibec recommends

The establishment of a competitive tendering process open to towns and cities around the country that would give access funding to support the regeneration/development of their town/city. This funding could in turn support the resource requirement which exists in such towns/cities in the form of a Town Centre Manager who would have responsibility for encouraging the development of commercial centres in towns/cities. Such an initiative could be run in conjunction with the roll out of a Town Centre Strategic Development Plan as devised by a sub-group of the Retail Consultation Forum.

How Ireland will benefit

The regeneration and revitalisation of our towns and villages will make them more attractive places to live and work and enhance their potential to provide employment, commercial opportunities, social and cultural facilities into the future.

Exchequer cost/benefit

€10 million (initial pilot scheme).

4

Investment and housing

The new Programme for Government commits to spending an additional €5 billion on capital over the term of the current Capex plan. It also commits to bringing a review of the plan forward to 2017 in order to effectively target appropriate capital projects. These are both welcome developments but are unlikely to be sufficient in order to head off the real risk the economy faces following a decade of underinvestment. Averaging 2.2% of GDP per annum, even with added expenditure, the Exchequer contribution to the new capital plan will be the smallest on record (since 1970) and likely its smallest in the post-war era.

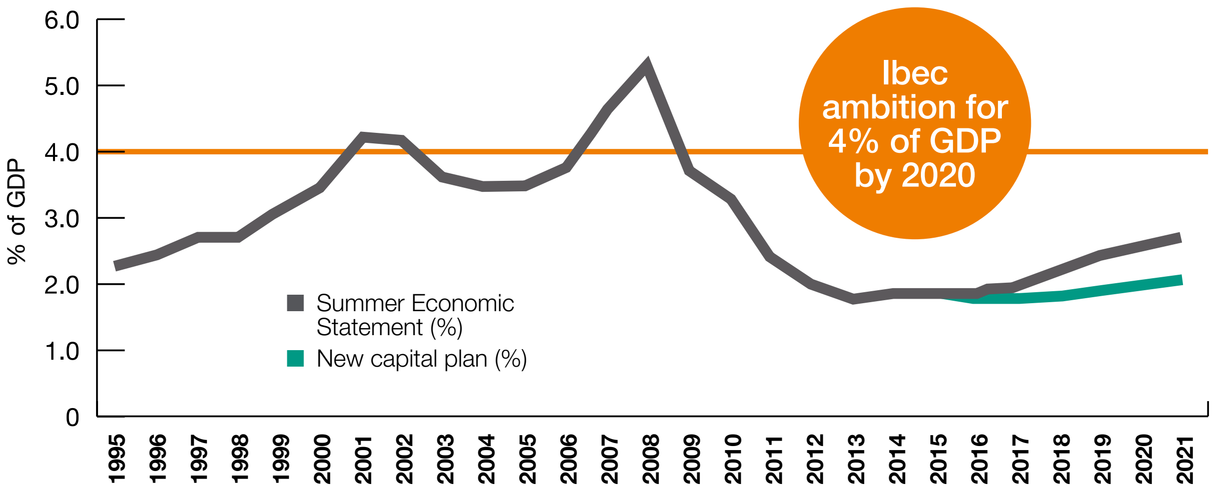
Ireland has a relatively weak public infrastructure, as witnessed by our international rankings, and the fastest growing population in Europe. At the same time our average level of investment has been half that of our European competitors - many of whom have spent between 3 and 4% of GDP over decades on public investment. Over the long-term this investment will be a key driver of competitiveness. As such Ireland should be spending at least the equivalent of 4% of GDP on public infrastructure.

4.1 Investment

16 Issue 16: The capital budget

The reality of the low level of public investment was laid bare in recent reports by both the European Commission and the Fiscal Advisory Council which showed the vast majority of public capital spending would be committed to maintenance and repair with little going to new build. As a result, the total stock of public infrastructure in Ireland will, at best, remain at relatively low levels. This is at a time when Ireland is facing into rapid demographic growth and overheating pressures in transport, education, water, broadband, health and other public infrastructure which are affecting Ireland's competitiveness.

Figure 8: Public capex % of GDP



Source: National accounts, Ibec calculations

Ibec recommends

Under the fiscal rules it will be difficult to enhance public investment sufficiently in order to meet the demographic or economic pressures Ireland will come under. Increases in capital spending under current plans will be backloaded until 2019 – with most projects unlikely to be completed before 2022 at the earliest. By this time, it is likely Ireland will have critical infrastructure deficits across a number of areas – having seen over a decade of underinvestment relative to any international or historical norm. In the face of the potential impact of Brexit it would be a mistake for the Government to row back on existing funding allocated to public investment from 2018 onward.

Where fiscal space dissipates it should come from the €3 billion in funding currently earmarked for the rainy day fund with other sources used to put together a reserve cash fund. This is the only prudent course at a time when interest rates are at an all-time low (allowing for the cheap carry of debt financed cash reserves) and when the State has significant liquid value built up in both cash, ISIF and the retained value in the pillar banks (cumulatively worth in the region of 15% of GDP). Budget 2017 instead should see some provision made in order to aid fast tracking of planning and procurement for key projects.

How Ireland will benefit

During previous slowdowns the first budget item to lose out was the capital budget. Ireland's experience both in the early 1990s and in recent years is that the cyclicality of our investment spending only exacerbates downturns and stores up major infrastructure shortages for the recovery. The consequences of these mistakes are clear in our housing and key infrastructure – they should not be repeated.

Exchequer cost/benefit

The Government should commit an additional €100 million in order to fast track key capital expenditure projects in 2017.

17

Issue 17: Investment under the fiscal rules

The fiscal rules by their nature differ from corporate accounting treatment by realising the full upfront cost of Capex in the four periods after the expenditure is sanctioned rather than over the lifetime of the asset. For example, a social house costing €180,000 would incur an exchequer cost of €45,000 on the first year of its construction under the current fiscal rules (€180,000 smoothed over four years) and a further €45,000 in each of the next three years. This is despite the fact that when an asset is debt financed its actual cost in that year will be the sum of interest costs on the debt plus any upkeep costs. The recorded first year cost of recurrent spending on rent allowance would seem to be only a fraction of a capital build under the current fiscal rules. However, over the lifetime of a house the current spending cost would amount to multiples of the construction cost.

This, allied to the short-term horizons of governments, is a major reason many policies which are both preferable and more cost effective in the long term do not get funded. In the case of social housing this means that spending tens of millions per annum on hotel beds or funding rent allowance is easier to achieve than house building. The same can be said of projects in multiple other areas such as public transport, energy retrofitting, water and prefabs versus capital spend in schools.

Ibec recommends

Ibec supports the fiscal rules for day to day spending and taxation. However, conventions in government accounts, which would be considered non-standard in any other setting, mean these rules bias against sensible long-term investment. The fiscal rules should be reformed to include a separate capital account more in line with its corporate treatment. This would include spreading the fiscal cost of assets over their lifetime.

Concerns about these changes allowing excess build-up of debt could for example be overcome by limits on debt financing of capital expenditure or by setting targets for capex or interest on capex as a proportion of tax revenue. In either event it should be kept in check by the current debt rule.

To ensure better value for money for the taxpayer from these projects it would be sensible to establish a National Infrastructure Advisory Council reporting to the Oireachteas which would advise on appropriate projects and the efficiency of public spending.

How Ireland will benefit

Ireland and Europe would benefit by allowing a greater proportion of strategic investments to be made by recognising that their capital cost is not the same as a recurring cash flow or operational cost. In the long-term, removing this barrier – by operating under more generally accepted accounting principles – could save European States money by reducing the need for otherwise sub-optimal current expenditure.

Exchequer cost/benefit

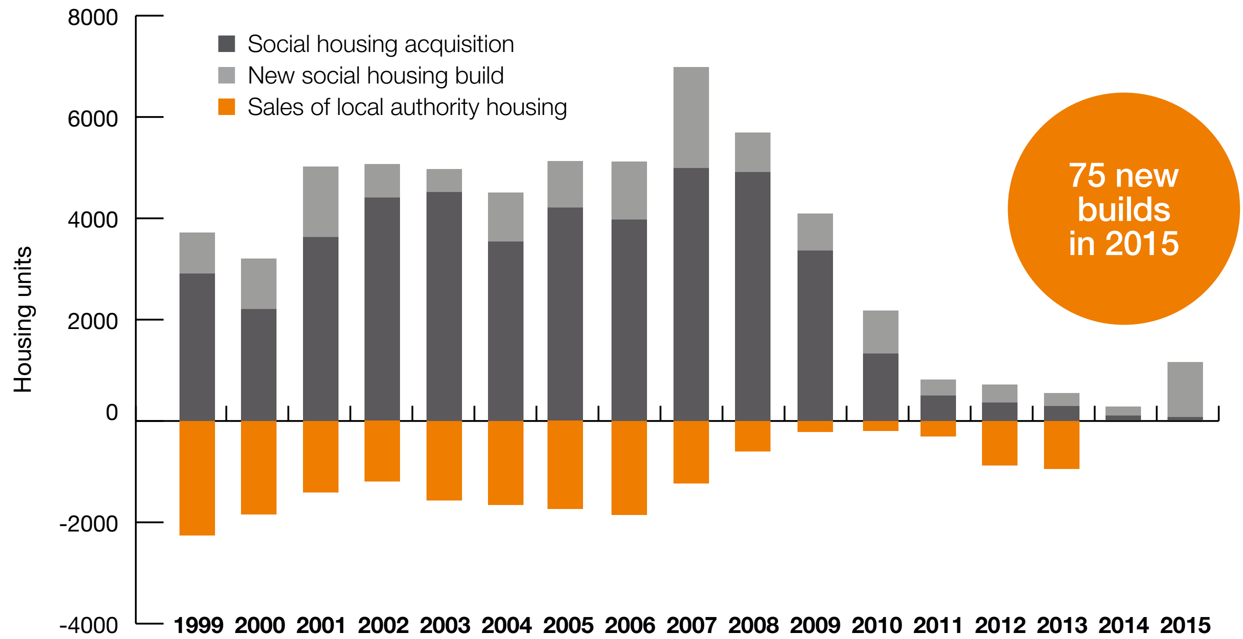
Cost neutral.

4.2 Housing

18 Issue 18: Social housing

It is clear that the State needs to play a significant role in the provision of affordable housing for those who cannot afford private rents. Failure to do this will lead to a build-up of social and economic problems – such as desegregation, competitiveness pressures and urban sprawl. Under the current fiscal rules it will be difficult to deliver sufficient social housing over the coming years. In 2015 the Irish State delivered 75 new build social houses at a time when demand is at an all-time high. Housing acquisition, which has been the preferred form of social housing provision for local authorities, will only make the housing crisis in the rental sector even worse and push families back into the system.

Figure 9: Net social housing delivery 1999-2015



Source: DCNER

Ibec recommends

In their recent joint statement on Brexit, President Hollande, Chancellor Merkel and Premier Renzi noted that Europe must strengthen in areas where both economic and social priorities overlap. In Ireland there is no one policy which provides a better opportunity to address both objectives in tandem than that of housing. Within this context, the State should seek derogation from the European Commission in order to borrow €1 billion outside the fiscal rules for the purpose of social housing. This borrowing would be backed by existing social housing assets as outlined in issue 18.

How Ireland will benefit

Securing this derogation would be a crucial step to allow for a structural reform of how we deliver housing in Ireland. Importantly, it would be more beneficial in the long-run both economically and socially but also fiscally. How we currently deliver housing has not served the State or its citizens well. This derogation would provide an opportunity for a structural break in Irish social housing provision which is not possible within the constraints of the current fiscal rules.

Exchequer cost/benefit

€1bn, debt financed.

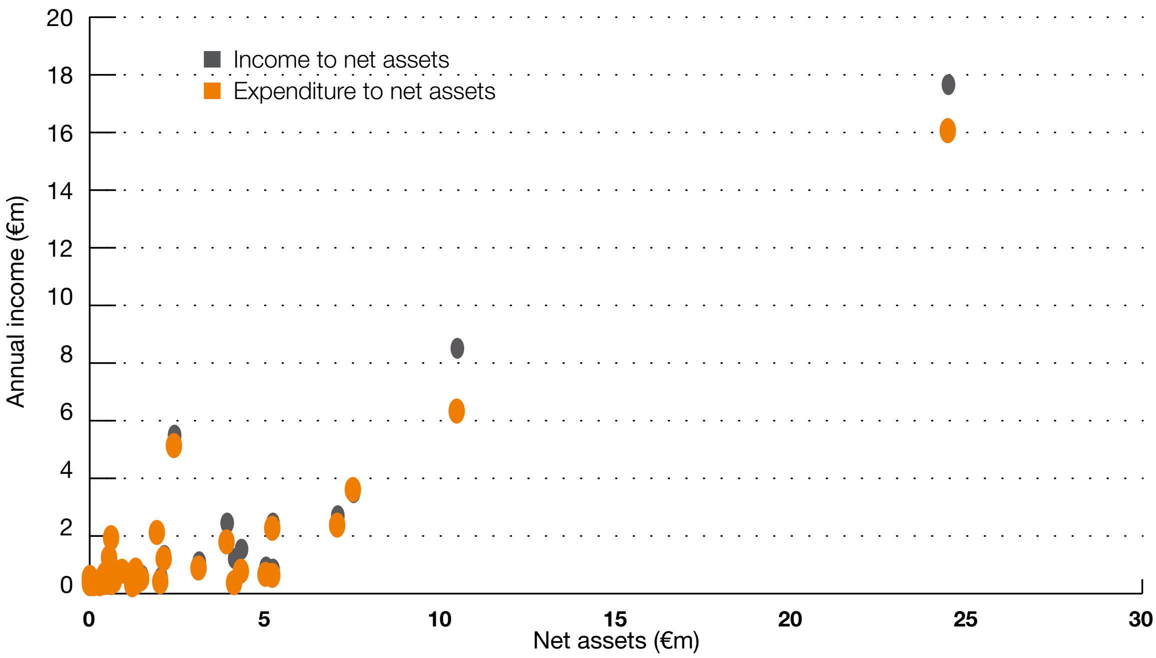
19

Issue 19: Reform delivery of social housing

Reports by multiple bodies have spelled out the institutional barriers to delivery of social housing. Local authorities remain the largest provider of socially rented housing (130,000 units) in the State followed by much lower levels coming from voluntary housing bodies (27,000 units). Existing low rent levels, tight staffing conditions and funding allowances for local government make it difficult for local authorities to increase the existing stock of social housing in the immediate term. As a result, the local authority sector has, in effect, pulled out of social housing provision, albeit in an unstructured way. Turning this around using public funding would require significant investment. Under the current framework this remains unlikely to change. In other European countries housing providers are increasingly separate from local authorities. In both Denmark and the Netherlands almost all social housing is provided by housing associations. In Sweden arms-length municipal housing companies are run under legislation in a 'business like' manner. Other institutional vehicles will need to be found for the delivery of social and affordable housing in Ireland.

Source: Benefacts.ie

Figure 10: Income & net assets of the 40 largest Approved Housing Bodies



Source: Benefacts.ie

Ibec recommends

Housing associations and third-sector bodies are currently a relatively small provider of social housing as a proportion of overall supply. Much of this is due to a number of capacity constraints related to the disparate number of these bodies and their small individual size. Less than 6% of the approved housing bodies have income streams of more than €1 million and only two have net assets (including housing stock) of more than €10 million.

Currently there are private sector funds which have the potential to benefit the sector. This private funding to off-books public sector or voluntary sector funding should assume a much greater role in the provision of social housing in Ireland; as is the case in much of mainland Europe (including France, Germany, Netherlands and Sweden). However, there are a number of important issues which must be overcome:

- The current provision is fractured with a lack of scale – as a comparator. Table 1 shows the number of housing bodies, the total number of units they manage and their average number of units across a number of other EU countries.

continued overleaf

continued from previous page

Table 2: Voluntary housing bodies and provision by country

	Housing bodies	Housing units managed	Average number of units
Denmark	700	520,000	743
Netherlands	500	2,400,000	4,800
Northern Ireland	22	47,000	2,136
England	1,500	2,500,000	1,667
Scotland	161	277,000	1,720
Ireland	520	26,000	50

Source: Various, Social Housing in Europe (LSE, 2007)

- Most of the Irish housing associations are managers rather than builders with weak institutional structures and governance.
- There are serious capacity and skills constraints when it comes to using private funding and housing delivery.

How Ireland will benefit

It is time to look at different models of social housing provision. This requires a renewed approach which involves transferring existing social housing stock out of local authorities and into a central provider of social housing which can work with housing associations and avail of external finance and expertise. This body could help build scale that would be attractive to institutional investors and/or a Government backed body to help guide funding to them. In the longer term, if operated on a commercial basis, it could take funding of social housing in the main off the Government's balance sheet completely. In recent years funding provisions came from the proceeds from cyclical upturns in revenues. These funding streams will be limited in the future with the consequent need to structure social housing provision in a manner which can access sources of external finance in an acyclical manner.

Exchequer cost/benefit

Funding for exploratory studies for amalgamation and upskilling should in the first instance be provided for voluntary housing bodies of sufficient scale. The cost of this would be minimal in the first year, totalling less than €1 million.

The State should begin work on the formation of a unitary state provider of social housing. This could be based on Northern Ireland's Housing Executive (NIHE) which over the long-term has achieved success in this area both building in its own right but also through supporting a healthy voluntary sector. Local authorities could play a role in identifying need within this system with delivery the responsibility of this new scaled body. This would cost €50 million and would come from funds outlined in issue 17.

20 Issue 20: VAT on student accommodation

In addition to Irish students, previous estimates by Property Industry Ireland show that there are some 11,000 international students and almost 100,000 English language students in Ireland, contributing €1.2 billion to the economy each year. The presence of large student populations in urban areas without the provision of adequate accommodation puts pressure on rents and prices, driving other renters out of the market.

Ibec recommends

VAT currently cannot be claimed back for student accommodation projects because it would not be possible to pass the cost on to students and is instead treated as a cost of development. Other countries, such as Australia, have tackled the problem of increasing private sector rents through targeted reform of the tax base of the student accommodation sector. Government should introduce a time limited (3 year) reduced 9% rate of VAT for student housing in Budget 2017.

How Ireland will benefit

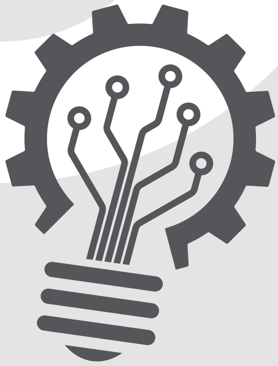
Introducing a time-limited 9% VAT rate on these developments for the period of three years will assist in closing the supply-demand gap in student housing. This would also have the dual benefit of having little attached cost (due to the current low scale of construction in the sector) and being targeted at urban areas where pressure on housing and rents are greatest.

Exchequer cost/benefit

The average cost of a large student accommodation project is in the region of €85,000 per bed space. There are currently 33,000 student beds in on campus accommodation in Ireland. Increasing this by a further 5,000 over the lifetime of the scheme would cost in the region of €18 million in VAT foregone or €6 million per annum on a static basis.

> "Ireland's experience both in the early 1990s and in recent years is that the cyclicality of our investment spending only exacerbates downturns and stores up major infrastructure shortages for the recovery."

Innovation, skills and labour market participation



The benefits from education are reaped over the longer term. Ireland is currently benefiting from achievements made in previous years with one of the best educated workforces in the EU. This is commonly cited as one of the main reasons why companies decide to locate here. In order to maintain this advantage and to further our success, we will need to continue investing in these areas. These potential long-term gains should not be side-lined in favour of other short-term spending.

Third level education has been put under severe pressures in recent years. Rising student numbers combined with funding cuts have meant that the current funding model is unsustainable. In order to keep the quality of our third level institutions at current levels the Government has two options. The first is to keep student numbers constant as the population of those who are of college going age and the demand from mature learners grows. This would cause attainment levels to fall and critically undermine our aspirations to be a 'knowledge-intensive economy'. The other, is to put a sustainable funding structure in place.

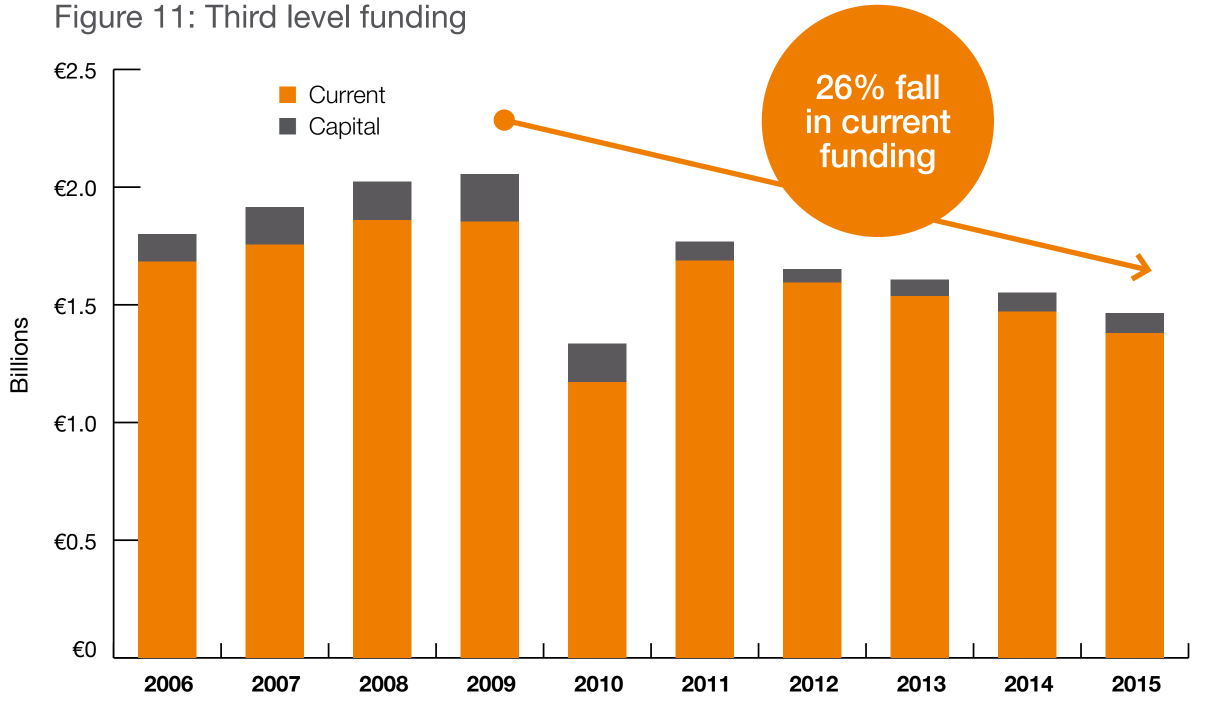
Other areas that are crucial for our long-term growth are spending on upskilling, career guidance and support for programmes with close links to the labour market, such as apprenticeships. Investing in skills can help transform the kinds of employment on offer, as employers will find it easier to recruit skilled workers. It will also help bring those who are long-term unemployed back into the workforce. Ireland also has a low level of in-work training and bringing this up to the European average will improve our competitiveness. Spending on R&D is currently below target. This spending is crucial for competitiveness and making Ireland an attractive place to invest. Additional funding is now needed to ensure that we don't start moving further away from our current target.

Ireland needs to have the social infrastructure in place to ensure that work pays for individuals. Ireland's childcare costs are currently among the highest in the EU, reducing the incentives for parents entering the workforce. Once children are then of school going age, not only is affordability still an issue but availability is one too as there is a limited range of after-school services which cater for working parents. Employment rates of females continue to lag well behind their male counterparts. This provides a significant pool of potential workers who could re-enter the workforce if the right conditions were in place. Currently however, financial enticements are limited and effort is needed to adopt measures to provide incentives to return to the workforce.

Issue 21: Third level funding

Third level education has been put under severe pressures in recent years. Public expenditure has fallen by 30% since 2009. The majority of this fall has come from reductions in capital spending (i.e. buildings and labs) which is now 60% lower than 2009 (current spending is 26% lower). While these cuts have been happening, student numbers have been growing (21%). As a result, public expenditure per student has fallen by 23%. The current model for funding in third level is unsustainable and needs to be addressed.

Figure 11: Third level funding



Source: PQ

Ibec recommends

In order to address this problem, the Government should start reversing the damaging cuts of recent years. It should increase capital spending in third level by €10 million as this area has suffered the most. This will avoid running the asset base down further. Government should also adopt more innovative approaches for capital funding such as PPP's.

Part of the €400 million of fiscal space dedicated towards demographics will be used to increase current spending at third level. However, due to significant cuts in recent years, an additional €5 million should be allocated towards this funding. The Cassells report has recommended a number of sustainable funding stream options for the future of third level education. Ibec holds that the most effective way of doing this is to implement a fees and loan scheme.

How Ireland will benefit

Ireland's high skilled labour force has played a key role in its economic success. The proportion of the population with third level qualifications has doubled in the past ten years with 52% of those aged 30-34 with such qualifications. This has meant that Ireland has the highest level of educational attainment in the EU. This asset will be threatened if funding issues are not addressed soon. In the next five years, the number of people who are of college going age will increase by 25%. In order to keep our current attainment levels constant, this would mean that an additional 26,500 students would need to be catered for at third level.

Exchequer cost/benefit

€15 million for third level capital spending.

22

Issue 22: Funding for upskilling

In the past three years, the unemployment rate has fallen dramatically to 7.8%. This recovery has come about largely due to a fall in short-term unemployment that is now back to pre-crisis levels. However, the unemployment rate is still relatively high and this is because long-term unemployment is still double what it was, accounting for 57% of unemployment. Apprenticeships, traineeships and programmes with close links to labour market needs (such as Springboard, Momentum and ICT Skills Conversion Courses) can help reduce this, by providing these individuals with new skills that are in demand by companies and get these people back to work.

Ibec recommends

Funding is needed to broaden the types of apprenticeships on offer to meet the skills needs of industry while providing real choice for potential workers. A ring-fenced fund should be established to support the development of new apprenticeships and traineeships.

How Ireland will benefit

The returns from investing in education mainly accrue in the medium and long term. This investment needs to happen today, in order to reap the benefits in the future. Investing in skills will help transform the kinds of employment on offer, as employers will find it easier to recruit new workers with the necessary skills, who in turn will improve the quality of work. In order to bring long-term unemployment back to its previous levels, reskilling is needed to equip these workers with the skills needed to re-enter the workforce.

Exchequer cost/benefit

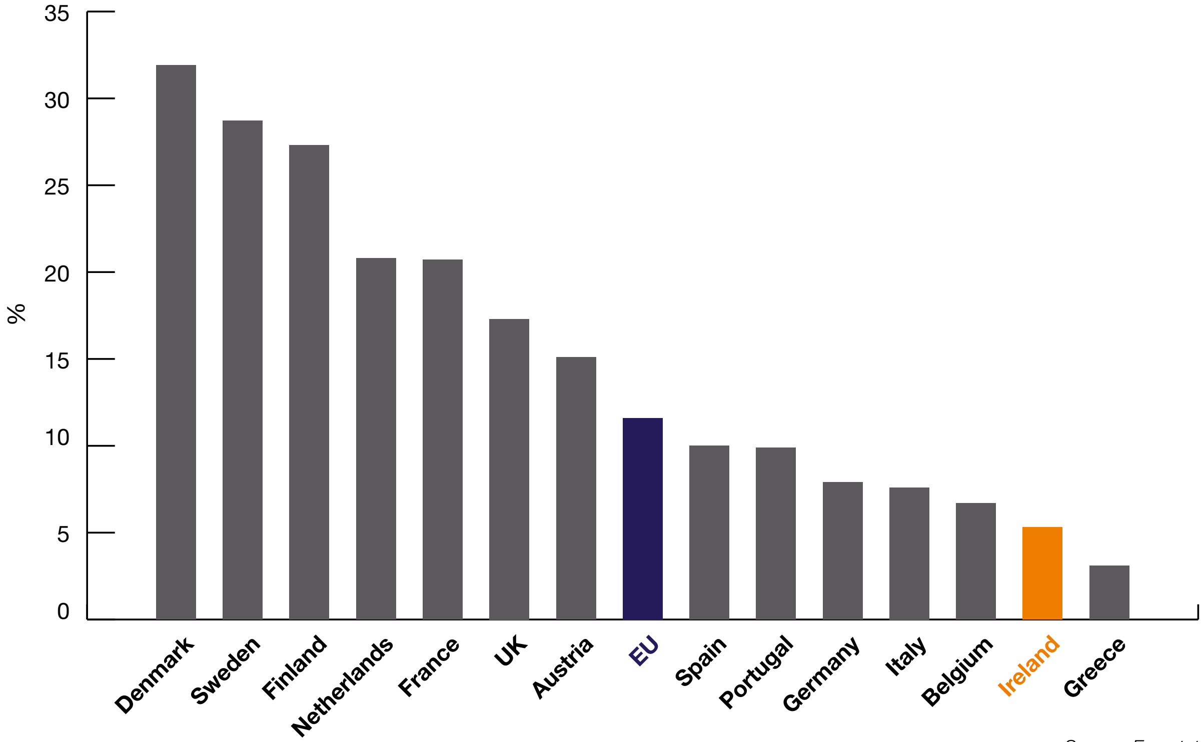
€5 million.

> "Apprenticeships, traineeships and programmes with close links to labour market needs can help reduce unemployment, by providing individuals with new skills that are in demand by companies and get people back to work."

Issue 23: Focus of the National Training Fund

Ireland performs poorly in terms of lifelong learning and upskilling. For those who are in work, only 5.3% are engaged in lifelong learning, less than half of the EU average. In recent years, this has been falling, as it was 1% lower in 2015 than 2013. Not only does Ireland lag behind the EU average, but it is far behind the top performing countries such as Denmark (31.9%), Sweden (28.7%) and Finland (27.3%).

Figure 12: % of employed persons engaged in training



Source: Eurostat

Ibec recommends

The National Training Fund currently only allocates one fifth of total funding to training for those who are currently in employment. However, given that unemployment has fallen significantly in the past few years at least half of this fund should be used for in-work training. This would enable the restoration of funding to upskilling programmes, such as Skillnets, with a proven track record of robust training needs analysis, curricula designed in collaboration with employers and work-based training.

How Ireland will benefit

During the crisis it was necessary to re-direct more of the funding into re-activation programmes which helped people get back to work. However, a new approach is needed so that the recent fall in unemployment is reflected in how these funds are allocated. Allocating a greater share of the current budget towards in-work training will help address skills gaps which have already started to emerge. We need to focus on the sustainability of existing employment by improving our competitiveness through upskilling and re-skilling.

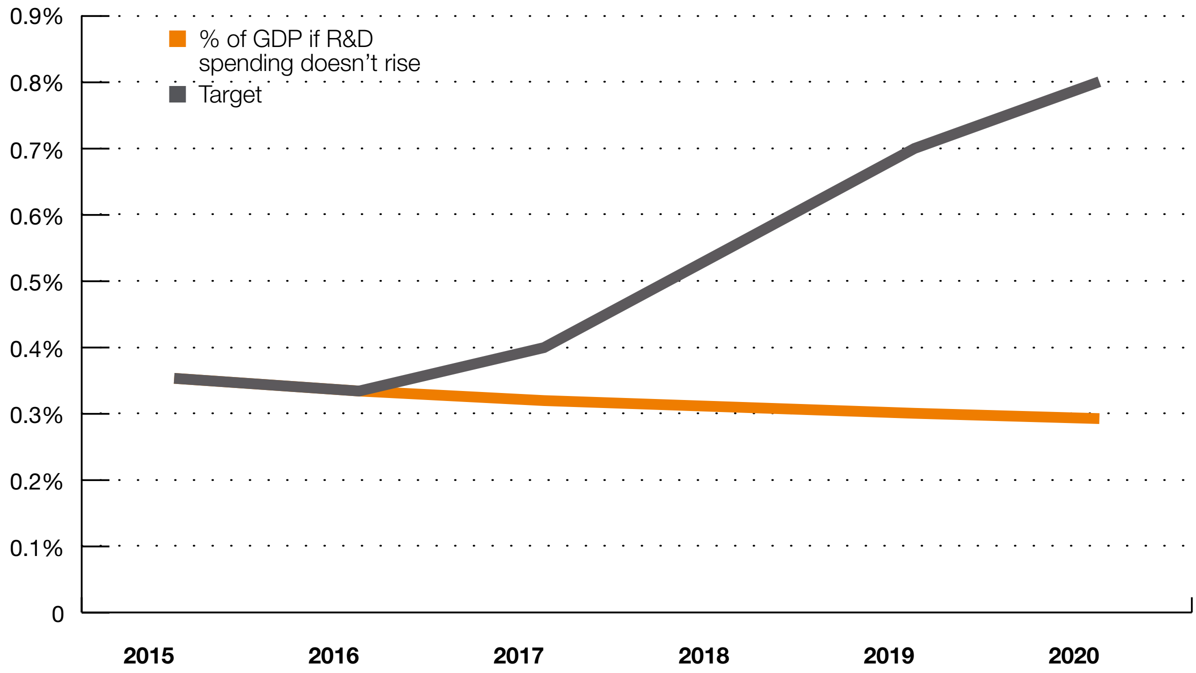
Exchequer cost/benefit

Cost neutral.

Issue 24: R&D spending

In 2014, total spending on R&D was 1.5% of GDP. Compared to other countries this share is very low as the European average is currently 2%. The primary reason for this shortfall is that government spending on R&D is low, as in 2014 it was only 0.4% of GDP – a quarter of the overall total. The ideal split according to the Barcelona targets of the Lisbon Agenda is that 1/3rd of total R&D spending should be financed by Government. Unless this spending grows at the same rate as nominal GDP, we will move even further away from that target. Last year, partly due to strong growth, Government spending on R&D fell to 0.35% of GDP. In 2017, if there is no increase in the upcoming budget, this will fall to just 0.32% of GDP.

Figure 13: Government R&D Spending (% of GDP)



Source: Eurostat and Ibec estimates

Ibec recommends

In order to prevent us moving further away from our targets and to keep Government spending at 0.4% of GDP an additional €150 million would need to be allocated to R&D.

How Ireland will benefit

The benefits from investing in R&D are long term and a key factor in driving sustainable economic growth. Success is complimentary and for every €1 the Government invests in R&D, industry spends €2. Given that Ireland is a small open economy, it is essential that we remain an attractive place to conduct R&D as well as facilitating the emergence of indigenous firms and encouraging innovation in key sectors.

Exchequer cost/benefit

€150 Million.

Issue 25: Cyber security voucher scheme

The security and resilience of digital infrastructure is an important aspect in enabling digital uptake and innovation in the economy. Internationally, cybersecurity is recognised as an important operational and brand issue for companies. Other studies indicate that 68% of the potential digital value at stake over the next decade for the private sector is tied to cybersecurity by design. The benefits that stem from the use of digital technology in banking, communications and electrical grid must be safeguarded – cybersecurity underpins any competitive digital economy.

Ibec recommends

In order to improve this area, the Government should assist SMEs through a €2,500 cybersecurity voucher scheme similar to the current trading online voucher scheme.

How Ireland will benefit

To enable a competitive economy, we must encourage continued digital innovation and investment in innovative digital products and services. Ireland's digital economy is a major driver of growth and we have the potential to be a global leader in this area. However, to make this a reality we must ensure that we have an environment that adequately protects personal data and IP, while providing the conditions for businesses to invest in the creation of innovative products and services.

Exchequer cost/benefit

€2 million.

> "The benefits that stem from the use of digital technology in banking, communication and electrical grid must be safeguarded - cybersecurity underpins the competitive digital economy."

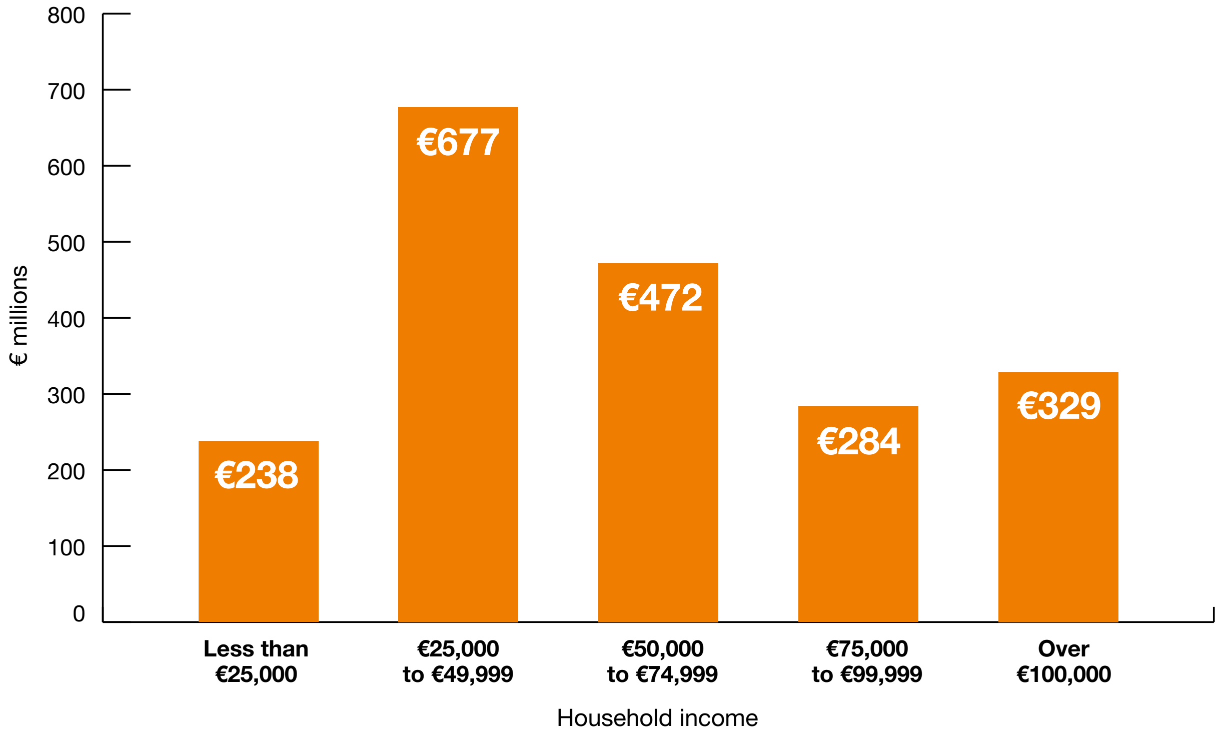
26

Issue 26: Childcare

Childcare costs in Ireland are among the highest in the OECD, accounting for 53.5% of the average wage in Ireland, compared to an average of 27.6% in other OECD countries. This is largely because in other countries, childcare costs are heavily subsidised by the State. While Ireland has a relatively low level State funding for childcare, we have the second highest direct payments to parents of any OECD country because of child benefit. These payments however are poorly targeted, with 17% of payments going to households who earn more than €100,000 a year.

In Ireland there is currently no formal after-school care system in place that is regulated and there has been limited research conducted in this area. The current Irish school day does not reflect the needs of working parents and the availability and affordability of after-school care is an issue. This affects both the participation of parents (particularly females) in the workforce and the nature of their participation. Not only are availability and affordability issues but so is the quality of services.

Figure 14: Child benefit payments by household income



Source: Household Budget Survey and Ibec estimates

Ibec recommends

Child benefit payments should be means tested so that they remain the same for low income households but taper off gradually for higher income households. This has the potential to save the Government €200-€500 million depending on the cut in point for tapering. These savings should then be redirected as follows:

1) Extension of the Early Childhood Care Education scheme.
2) Implementation of a formal after-school care system.
3) Continued professionalisation of the early years' service. In addition to the higher capitation grants, the ratios (i.e. workers per child) should be relaxed if the worker in question has a level 7 qualification or above. This would provide a greater incentive for providers to encourage workers to obtain these qualifications.

How Ireland will benefit

Current childcare costs are a huge deterrent for parents with children of these ages to continue working. Female participation rates are relatively low in Ireland and the differential between male and female participation is much wider than in other European countries. The employment rate for women aged 25 to 49 in Ireland is almost eight percentage points lower than their UK counterparts. Child benefit payments are poorly targeted, with €330 million going towards households who earn more than €100,000 a year. If this money was redirected towards childcare services it would improve the financial incentive to work, increasing our labour force and the productive capacity of the economy.

Improving the quality of existing services will also bring benefits. The level of qualification of practitioners in early year settings has long been acknowledged as an important contributor to and indicator of quality service provision and while it doesn't guarantee high quality it is the best measure for the sector. The EPPE/EPPSE study (Sylva et al., 2012) among others has shown that the benefits of high quality early care and education persist to at least age 14 in relation to both academic outcomes (especially maths and science) and social-behavioural outcomes (e.g. motivation, self-confidence, empathy, impulsiveness, anti-social behaviour).

Exchequer cost/benefit

Cost neutral.

> "Ireland needs to have a social infrastructure in place to ensure that work plays for individuals."

Summary of recommendations and costs

Issue	Tax	Expenditure	Fiscal rules derogation
Issue 1: Entry point to the marginal rate of tax	170	0	0
Issue 2: Taxation of stock options	80	0	0
Issue 3: Private sector pensions	27	0	0
Issue 4: Tax credit removal for higher earners	0	0	0
Issue 5: Taxation of sugar	0	0	0
Issue 6: Alcohol excise	50	0	0
Issue 7: The 9% tourism VAT rate	0	0	0
Issue 8: Tobacco excise	0	0	0
Issue 9: Taxation of the self employed	60	0	0
Issue 10: CGT entrepreneurs' relief	52	0	0
Issue 11: Seed Enterprise Investment Scheme (SEIS)	8	0	0
Issue 12: R&D tax credit administration	0	0	0
Issue 13: R&D tax credit and SMEs	13	0	0
Issue 14: Management training incentives	3	0	0
Issue 15: Town Centre Regeneration	0	10	–
Issue 16: The Capital budget	0	100	0
Issue 17: Investment under fiscal rules	0	0	0
Issue 18: Social Housing	0	0	950
Issue 19: Reform of delivery of social housing	0	0	50
Issue 20: VAT on student accommodation	6	0	0
Issue 21: Third level funding	0	15	0
Issue 22: Funding for upskilling	0	5	0
Issue 23: Focus of the National Training Fund	0	0	0
Issue 24: R&D spending	0	150	0
Issue 25: Cyber security	0	2	0
Issue 26: Childcare	0	0	0
Total	**469**	**282**	**1,000**

5 things Government should deliver in Budget 2017

1 Stay the course on fiscal policy

This should involve policy choices which will solve strategic supply side problems and protect those industries most likely to be adversely affected by post-Brexit volatility.

2 Send a positive signal through wise investment

Investment in crucial capital and social capacity must be a priority. Given the low carry costs of debt, strong nominal growth rates, a primary surplus and considerable infrastructure gaps, investment can be achieved while reducing the deficit in a prudent manner.

3 Create a level playing field with UK for SMEs

The Government must ensure that enterprises do not face any regulatory, labour cost or tax increases while the current period of uncertainty exists. Ensuring a competitive tax offering for indigenous business has never been more urgent.

4 Align economic and social priorities through housing

Government should seek a temporary derogation from the European Commission to spend €1 billion outside the fiscal rules in delivering an additional programme of social housing beginning in 2017.

5 Give Ireland an edge for highly skilled workers

Along with investment decisions, which wil affect standards of living, including housing, access to education and public infrastructure, Budget 2017 must address key issues, particularly the treatment of share options, which currently make Ireland a less attractive location for highly skilled workers.

About Ibec

Ibec represents Irish business; home grown, multinational, big and small, spanning every sector of the economy. The organisation and its sector associations, work with government and policy makers nationally and internationally, to shape business conditions and drive economic growth. It also provides a wide range of professional services direct to members. Ibec has over 200 professional services staff in seven locations and is the umbrella group of 42 different sectoral industry associations. In addition, Ibec operates 15 policy committees. Ibec's Economic and Taxation Committee for instance provides a cross sectoral platform for business to engage and influence policy at a national and EU level. The range of both trade associations and policy committees within it, place Ibec in a unique position of being close to the challenges and concerns of business operating in and from Ireland.

Ibec Economic and Taxation Team

Ibec economic and taxation team represents and informs members on a broad range of economic and taxation issues providing three core services:

Publications

Our regular research documents such as the Quarterly Economic Outlook provides in-depth analysis of the most recent Irish and international economic developments as well as Ibec's forecasts on economic growth, inflation and employment.

Policy

Ibec economists engage with policy makers at a national and international level on issues of importance to business. We make submissions to government departments and state bodies on economic and taxation issues including the budget, taxation, investment, public expenditure, wages and broader economic and business issues.

Services

In addition to our extensive policy engagements and published information, Ibec members are welcome to contact us directly. We can help you find economic information relevant to your business planning and budgeting needs, including inflation, GDP growth, wage comparisons and other economic data. We will also provide bespoke in company briefings on economic and taxation-related maters.

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