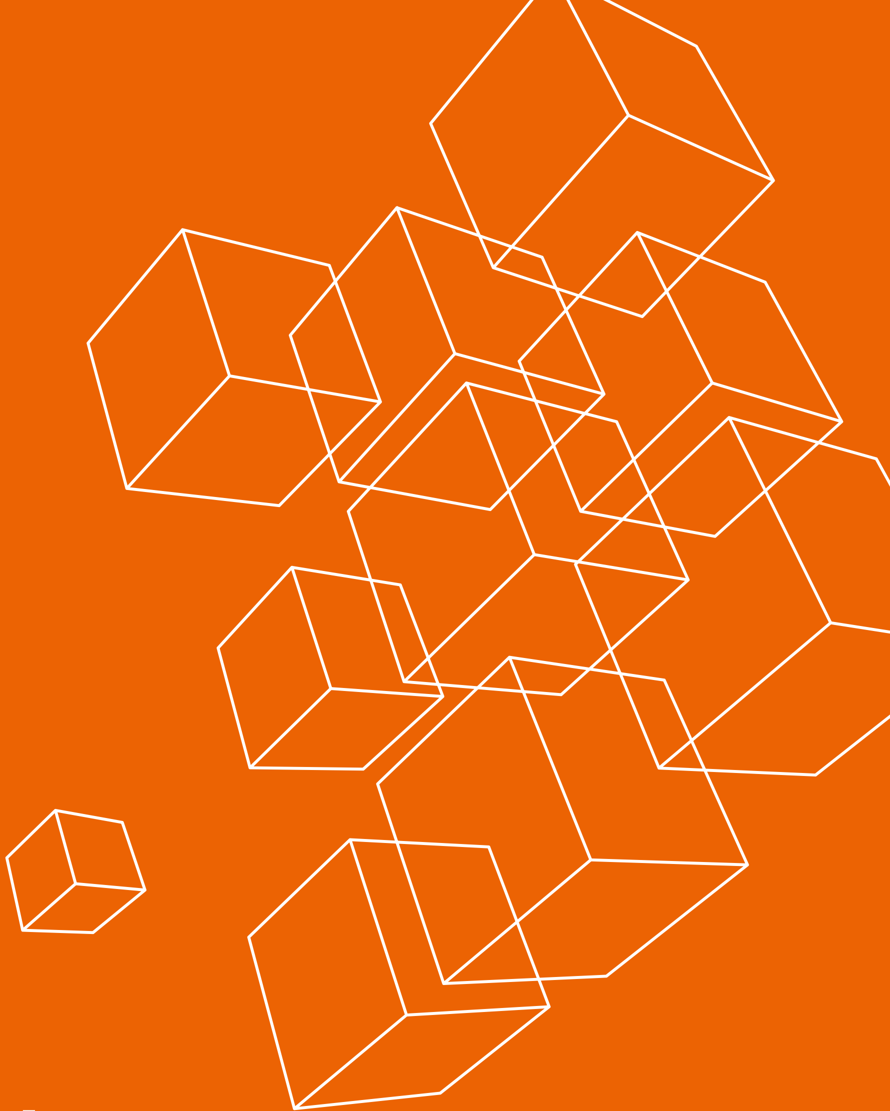


Ibec
For Irish Business

Ibec submission
Budget 2018

Building for the future

“While Government must address the impact of the *force majeure* that is Brexit for Ireland, it must also use the opportunity of Budget 2018 to build on the success and substance of the Irish business model (…)”

Foreword

Every year at Ibec, in advance of Budget day, we support our membership across all sectors and regions of the business community to tease out and define the business priorities. This year is no different, in process that is. The feedback, however, from our membership has never been more stark nor has it been more consistent on the lack of infrastructure capacity as the single biggest issue facing Ireland's competitiveness.

From capital development to soft infrastructure, business has coalesced on the need for immediate and much greater investment in transport networks, broadband, houses, schools and hospitals. These issues affect people's lives and are therefore challenges presented to both business and society.

Budget 2018 is therefore particularly significant for our revered business model. In the weeks ahead, colleagues and I will engage with stakeholders to communicate how, despite the well rehearsed constraints, it is firmly within the power of our own Government to spend more on investment. Failure to use the resources available to us will only serve to compound the investment crisis.

While Government must address the *force majeure* that is Brexit for Ireland, it must also use the opportunity of Budget 2018 to build on the success and substance of the Irish business model with its compelling track record of recovery from global recession to once again being Europe's fastest growing economy.

Danny McCoy
Ibec CEO

Budget 2018 context

The economy is at a critical juncture: it continues to grow strongly but is entering a period of inevitable uncertainty due to both international pressures such as Brexit and the backlash against globalisation, and national ones such as demographic growth coupled with under-investment in public infrastructure.

Ireland's working age population is expected to expand by more than 20% over the next 20 years compared with a 4% fall in working age population in other developed EU countries. This represents a huge opportunity, but only if the potential can be harnessed and investment matches demographic growth.

The first imperative is to correctly diagnose the current challenges facing the Irish economy. The narrative that the economy is in danger of repeating the overheating experienced in the early 2000s is not borne out by the evidence: there is little sign of the loose credit or overconsumption of the 'Tiger' years; instead inflation remains low and consumption per capita is below 2007 levels.

As the saying goes 'generals always fight the last war', and the danger of focusing excessively on the potential for economic overheating is that this leads to prematurely putting in place measures, like 'a rainy day fund', at a time when the strongest threat to our competitiveness is a lack of capacity.

In this report, Ibec has identified issues currently confronting the Irish economy which should be addressed in the immediate and short term. These range from putting in place a Brexit mitigation fund to help indigenous Irish firms, to adequate funding for education and training; from improving the tax situation for SMEs, to investing in innovation.

What unites most of these issues and presents the most pressing challenge currently confronting the Irish economy, is the need to invest in our economic capacity, from capital development to soft infrastructure including education, health care and innovation.

Across a wide range of areas, from roads to broadband, poorly developed infrastructure pushes up operating costs directly for businesses by making trade more difficult or expensive. In Ireland the biggest driver of on-going wage pressures is the lack of housing supply, while higher commuting costs for workers mean lower productivity and higher wage demands.

Over recent years Ibec has consistently drawn attention to a lack of ambition when it comes to the Government's delivery of key infrastructure. In the early years of the crisis, this was unfortunate, but understandable. Today it is unwarranted: Ireland is a 21st century economy with a rising population but without sufficient infrastructure to match.

The Government's *Summer Economic Statement* contained a welcome change in tone on this front, showing more purpose on key infrastructural issues to match prudence about public finances. However more will need to be done to meet Ireland's demographic pressures.

Ibec believes that it is within the Government's powers to spend more on investment within the technical confines of the fiscal rules, if it so chooses. The path towards this should begin in Budget 2018.

Ibec key messages

5 things Government should deliver in Budget 2018

1

Additional fiscal space must be used to increase investment

The economy is growing quickly and sustainably. Despite this, there is a serious risk that underinvestment in public infrastructure coupled with strong demographic pressures will lead to overheating if action is not taken. The 2015 GDP growth has afforded us an additional €7 billion in potential investment capacity between 2018 and 2021 if the fiscal rules are obeyed. It is our view that maintaining the decision to forgo this additional space by excluding the 2015 GDP figure from fiscal space calculations would be a mistake. Using the additional space for investment to help solve our most pressing problems is possible whilst still running a significant surplus in day-to-day spending over the next four years. It would clearly be a mistake to embed this additional space into day-to-day spending but it would be sustainable and prudent to use the additional flexibility for one-off investment projects.

2

The Budget must be Brexit proofed

Brexit leaves the Irish economy exposed, particularly the indigenous sectors most reliant on the UK market (despite accounting for only 12% of exports, these indigenous exports spend as much in the domestic economy through purchases and wages as the multinational exporters, and employ as many people with greater regional spread). It is vital we take decisive steps in Budget 2018 to offset such risks. In order to support businesses, a multi-annual framework for funding Brexit mitigation should be put in place. Funds should be targeted at supporting innovation, market diversification, upskilling and capital expenditure in equipment and machinery. The resources required will be in the region of 5% of the value of current annual export sales to the UK by Irish indigenous firms, or about €1.2 billion over three years. This would be funded from both Government and EU sources. In addition, long-standing differentials in the tax treatment of Irish SMEs compared to those in the UK must be closed in order to ensure that Ireland remains the location of choice for indigenous firms.

3

Focus on creating a high-skilled economy

Unemployment is falling rapidly and we expect it to average less than 6% in 2018. However we still face many labour market challenges. Ireland's prime age employment to population ratio remains 29th out of 34 OECD countries and female labour force participation remains particularly low. In addition, skills gaps are becoming even more acute. We must re-double our efforts to overcome these issues by prioritising education and life-long training, by reforming our tax and share options systems to attract high-skilled workers, and improving childcare affordability and quality, by targeting existing resources better.

4

Defend our Foreign Direct Investment model where necessary and improve it where possible

Recent years have seen the advent of the OECD's Base Erosion Profit Shifting (BEPS) process which represents the single biggest change in the global corporate tax system in living memory. At a European level we have also seen the re-emergence of Common Consolidated Corporation Tax Base (CCCTB) proposals, and whilst the outcome is still far from clear, the prospect of US corporate tax reform has never been more tangible. Despite recent challenges, Ireland's model of a small, business-friendly open economy within Europe has continued to demonstrate serious substance, with accelerating investment and employment in highly globalised industries. Ireland's corporation tax strategy, while not the sole reason for this success, is a major part of our offering and must be safeguarded. Cost neutral administrative changes to the R&D tax credit, in particular, could significantly improve the benefits of an already successful scheme.

5

Put in place proper 21st century infrastructure to make sure Ireland maintains its competitive edge

Over recent years Ibec has consistently drawn attention to a lack of ambition when it comes to the Government's delivery of key infrastructure. In the early years of the economic crisis, this was unfortunate, if understandable, in the context of Ireland's fiscal position. Today it is unwarranted. Ireland is a 21st century economy with a rising population without sufficient new infrastructure to match. Along with increased Exchequer investment, better use must be made of public-private partnerships (PPPs), other non-Exchequer finance (such as the European Investment Bank) and disposal of some of the underutilised assets among the €100 billion of physical assets on the Government's books. Efficient delivery will be key and must be led by a comprehensive National Planning Framework.

"From capital development to soft infrastructure, business has coalesced on the need for immediate and much greater investment in transport networks, broadband, houses, schools and hospitals."

Contents

1 Introduction - The economy at a critical juncture

The Irish economy is at a critical juncture. Growth figures for 2016 show that our economy continues to experience strong growth as we enter a period of great uncertainty.

The decisions we make over the coming Budgets will be as important as those made during the austerity years. Ireland has weathered well the worst of the immediate impacts of Brexit, potential US tax reform and the backlash against globalisation. Significant challenges lie ahead.

Ireland enters this period of uncertainty with a positive economic backdrop. The economy is growing quickly; our young and well-educated population continues to expand and we have witnessed the return of net inward migration. Our view is that the substance of the Irish private business economy has never been stronger. Figures show that private sector employment grew by 6.7% annually in Q1 2017, Foreign Direct Investment (FDI) continues to run ahead of expectations and despite significant uncertainty, business continues to export and invest at record levels.

Diagnosing the challenge

Whilst it is of course important to remain vigilant, the narrative suggesting that the economy is under immediate risk of repeating the overheating experienced during the 2000s is mis-diagnosing the challenge. Certainly pressures are building in our cities – but these aren't being driven by the loose credit or unsustainable increases in consumption which we experienced in the past. We should be guided by the indicators we can observe: inflation remains low, consumption per capita is still 3% below its 2007 level and, although unemployment has fallen rapidly, our employment rate for prime age workers is 29th of 35 OECD countries. In addition, construction and credit levels are still far short of international norms, housing price-to-rent ratios are moderate, and a recent European Investment Bank (EIB) investment survey indicated that only 51% of Irish companies were operating at or above capacity. This current phase of growth is very different to the experience of the pre-crisis years.

What we are most at risk of experiencing is not an economy overheating due to excess demand, but the public infrastructure in our cities choking under extreme demographic pressures. We are now at the end of a decade where the volume and quality of public infrastructure has struggled to keep up with a nationwide population increase of over 400,000 people, which was 58,000 people (50%) higher than even the most optimistic scenario in our last national population projections in 2011. This demographic boom has inevitably resulted in pressures emerging, due to a partial transport network, an inadequate health infrastructure, an under-supply of quality housing, and an education system operating beyond capacity.

It's worth noting that we are on course to grow by over 900,000 additional people over the next 15 years – that's nine cities the size of Limerick. Without a new plan for spatial investment and development most of this expansion will emerge, unplanned and underserved, on the Dublin commuter belt.

The social implications of our capacity pressures are obvious. The impacts on business are less well documented but are a constant source of feedback from Ibec members. In areas from roads to broadband, poorly developed infrastructure pushes up operating costs directly for business by making trade more difficult or expensive. The biggest single driver of ongoing wage pressures is the lack of housing supply and higher commuting costs for workers mean lower productivity and higher wage demands. Brexit notwithstanding, the failure to address these issues is the single biggest threat to our competitiveness and economic wellbeing.

At the same time the dynamics are very different in many of our regions and rural areas which are hugely exposed to the impacts of Brexit. As we outlined in our submission on the National Planning Framework, it is likely that continued divergence will emerge in the absence of policy action. Failure to provide adequate investment in our regions will see these trends intensify. This will hurt both rural and urban areas alike.

Renewed ambition

Whilst vigilance on the Government's fiscal position is key, Ireland cannot remain paralysed by its recent past. Failure to invest in the productive capacity of the country will leave us even more exposed to the shifts in a global environment which is changing rapidly. The challenges brought on by demographics will not disappear; they will only intensify. The tide of a rapidly growing population can't be turned back and recent years have shown that inflows of capital and people have remained robust even through extremely challenging times. Ireland must increase its ambition to meet the challenges and opportunities this brings.

With this in mind, Ibec fundamentally disagrees with the notion of putting €1 billion per annum into a 'rainy day fund' from 2019. A fund of this size would make little material difference to the country's economic trajectory (as such a measure would equate to only 0.5% of total domestic demand). Ireland today is one of the world's most open countries in one of the most globally integrated eras of history. Ireland's extreme openness means many of the sources of growth – through both human and corporate migration – remain exogenous. If we want sustainable growth and to maintain external competitiveness, then the €1 billion per annum must be used to provide the infrastructural capacity to meet demographic demands. In this context, the Government's Summer Economic Statement was a positive change in policy direction. Whilst remaining prudent about public finances, the plan shows more purpose on the key infrastructural issues facing the country. This change in tone is positive from a business perspective as Ireland enters a period of great uncertainty.

The path ahead

The dual challenges of Brexit and a rapidly expanding population requires a re-prioritising of resources and being smarter about how to raise necessary funds. This includes drawing down more from the private sector and third-party bodies like the EIB. A failure to find the necessary resources will create long-term social problems for the country. Future generations will be left with larger infrastructure deficits to fill, in a time of higher interest rates and an ageing population. This will inevitably lead them to suffer higher rates of taxation than they otherwise would, along with poorer infrastructure and quality of life. As we have seen in other countries in recent times, social problems easily spill over into political uncertainty and polarisation.

As the threat of Brexit approaches, vigilance is required regarding its potential impact on the regions in particular. Ireland is not immune to trends seen in the US, UK and elsewhere.

Although the US case has received a lot of attention, Ireland has had a fall in mid-skill jobs since 1990 of greater scale. At 15% Ireland's was one and a half times the fall in the UK and three times the fall in the US. It is a testament to our business model, education system and strong safety net that these jobs have been replaced in net terms with higher value ones and new opportunities have been created for most of those impacted by globalisation. We do still face challenges and must re-double our efforts to deal with losses from Brexit, where they occur, by prioritising education, re-skilling, lifelong training and a much stronger focus on regional development.

At home and abroad, it is imperative that Ireland and Irish business continue to reinforce the narrative on the clear benefits of globalisation. Ireland's model of a small, pro-business and open economy within Europe has continued to demonstrate real substance with continued investment and employment in highly globalised industries. We must recommit to this model while striving to better develop indigenous industry at home. Ireland provides such a clear example of the benefits of EU membership. To ensure that this continues our EU partners will need to support us through Brexit by being more flexible in areas such as fiscal rules and State aid.

This submission lays out Ibec's view on how we can achieve the dual aims of protecting ourselves from Brexit and meeting the needs of a growing population. As we outline in the coming sections, this can be done while keeping a rein on day-to-day spending and gradually bringing down our debt.

"Ibec's view is that the substance of the Irish business model has never been stronger. Figures show that private sector employment grew by 6.7% annually in Q1 2017, Foreign Direct Investment (FDI) continues to run ahead of expectations and despite significant uncertainty, business continues to export and invest at record levels."

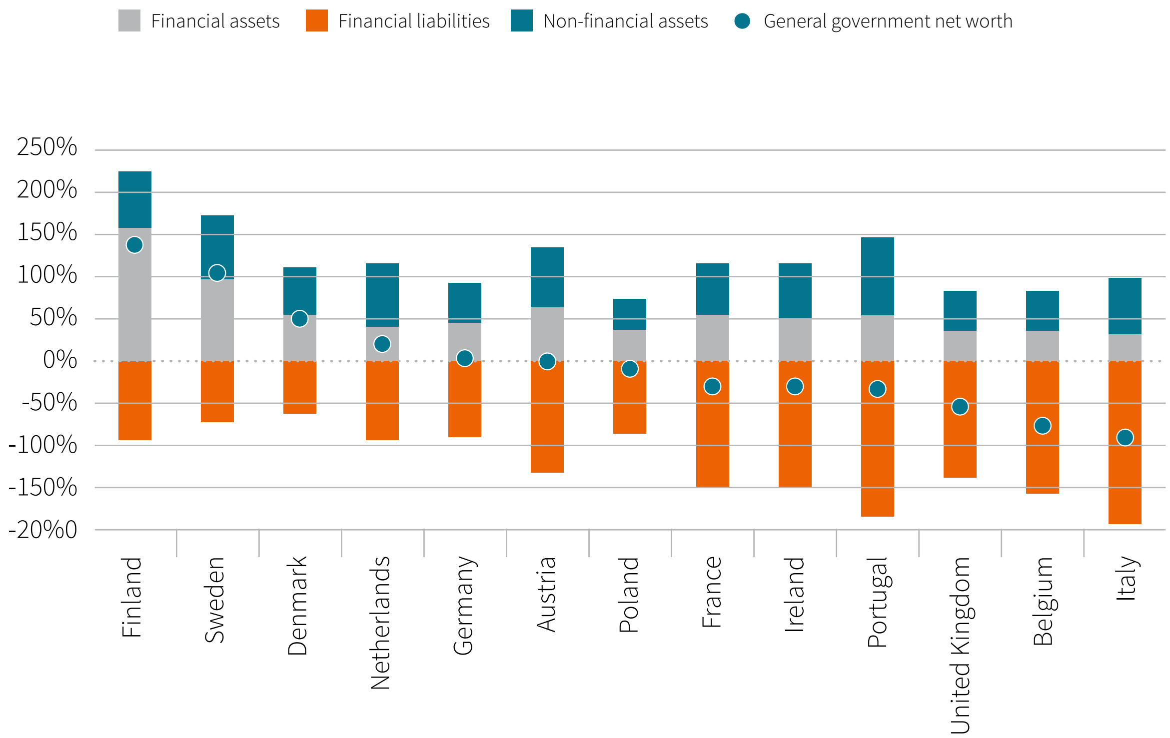
2 The fiscal context for Budget 2018

Ireland's fiscal position has improved rapidly, with debt ratios now reaching developed world norms and the State reaching a primary surplus (excluding interest payments) in 2015. By 2018 it is expected that we will have reached our medium-term objective under the fiscal budgetary rules, albeit with some timing uncertainty following the Brexit vote.

The Government has set out its intention to run a significant primary surplus (government revenue minus non-interest spending) over the period from 2018 to 2021 totalling €26 billion. Given that the average interest rate on our current stock of Government debt (3%) is lower than the potential medium term nominal GDP growth rate (of between 5% and 6%), both the debt ratio and the relative cost of debt servicing should fall significantly. In addition, over 90% of this stock of debt is also held at fixed rates which means the State is not significantly exposed to an interest rate shock.

Governments never pay down capital sums on debt. As such, the sustainability of Ireland's fiscal position is reliant on its ability to roll over Government debt on maturity. This, in turn, is reliant on a number of variables including potential growth rates, the maturity of Government borrowing, expected inflation and demographics. As Ibec has shown, Irish debt is held at relatively low interest rates when compared to our potential growth rate. In addition, a significant portion of Government debt is held at long maturity and fixed rates. Some 35% of Irish outstanding debt matures in 10 years or more compared to only 18.6% across other EU countries. Adjusted for inflation between now and maturity (assuming 2% average annual inflation), the real debt burden is likely to be in the region of three-quarters of today's headline value. Finally, Ireland has a very different demographic structure to other EU countries given our working age population is expected to expand by over 20% over the next 20 years. This is compared with an expected 4% fall in working age population of other developed EU countries.

Figure 1: Government net worth, % of net national income by country



In addition, while headline Government debt remains high at around €200 billion, net worth (total debt minus financial and non-financial Government assets) is significantly lower. Figure 1 presents Government net worth as a percentage of total net national income by country (in order to exclude 2015 Irish GDP growth). By this measure Ireland's total debt minus financial and non-financial assets is 34% of net income in the economy. Both including and excluding less liquid non-financial assets, Ireland is just above average amongst developed European economies.

Room for investment

In Ibec's view the Government's debt is relatively sustainable in a global context and potential growth and demographics means that it will become increasingly manageable over the long-run. A gradual reduction in debt levels should be possible while investing wisely in the economy as long as day-to-day spending and taxation are balanced over the medium term (i.e. balance the current budget). The Government intends to run a current surplus of €30 billion over the next 4 years. It must also be borne in mind that quality investment bears a return. Over the longer-term, the impact of investment on the productive capacity of the economy may mean that investment could be debt neutral.

A recent OECD study has gone into greater depth on the space for Ireland to invest in a manner which is debt neutral over the long-run.

The study looked at the number of years over which a country could finance a permanent 0.5% of GDP stimulus by increasing its deficit, without raising its public debt-to-GDP above the value it would have had without the stimulus by 2040. Of the countries studied, Ireland had the highest number at 6.3 years. This is due to below optimal (and falling) initial level of infrastructure, low public investment and strong potential nominal growth rates. These factors together result in a growth impact of investment to enable a debt financed investment expansion without long-term impact on debt to GDP. In other words, over the long run, investment expansion (0.5% of GDP for 6 years) would pay for itself. At a time of record low interest rates, it is sub-optimal therefore that 70% of Ireland's current capital plan will be paid for out of cash.

The fiscal space, business migration and corporate tax

Figures from the Government's Summer Economic Statement indicate that less than €1.3 billion is available in fiscal space for the upcoming budget.

This is then reduced to little over €300 million for new measures once pre-commitments, carryover effects from Budget 2017, and the impact of the Lansdowne Road public services pay agreement are taken into account.

Ibec has argued, however, that this constraint only exists because of a failure by both the Government and the European Commission to apply their own fiscal rules in a consistent manner. Under the common methodology the amount of fiscal space available is a function, in part, of the 10 year average (forward and backward looking) growth of potential output minus a 'convergence margin'. The level shift in GDP and capital stock in 2015 increased potential growth in 2015 to 24.5% (as calculated by the common methodology) from around 3.5% in 2014. This, in turn, should have increased the fiscal space available from 2016 onwards. This is due to both an increase in the 10 average potential growth rate from 2015 to 2020 and, if the additional fiscal space is used for investment, a higher expenditure base into the future. This has not been the case, however, due to a domestic policy decision.

Table 1: Fiscal space calculations with varying treatment of 2015 growth rates (€bn)

	2018	2019	2020	2021
Net fiscal space (Summer Economic Statement)	1.3	3.2	3.4	3.4
Net fiscal space (Ibec calculations)	1.7	3.5	4.8	5.3
Additional net fiscal space*	0.4	0.3	1.4	1.9

*Previous years additional fiscal space is added to the next years base. Cumulatively the additional expenditure afforded by €4 billion of additional space is €7 billion.

The Government's approach in both Budgets 2017 and 2018 has been to ignore the actual 2015 GDP growth figure and cast potential GDP growth in 2015 as the average of potential growth in 2014 and 2016. The complexity of the fiscal rules means that the political implications of this decision have received very little public debate. This will impact on the fiscal space available for the next number of years by reducing the 10 year average GDP growth rate.

Ibec's calculations suggest the cost of this in terms of reduced fiscal space for the Government could be in the order of €1 billion annually on average in each of the next four years, starting with €400 million in 2018. The impact that this has on the fiscal choices available to this and future Governments is substantial. Adding this additional fiscal space to investment would allow a cumulative increase in investment over four years of €7.2 billion over and above that which is already signalled in the Summer Economic Statement, whilst also allowing Government to run a current budget surplus in excess of €30 billion. In Ibec's view, the Government should ring-fence all of this additional fiscal space for capital investment between 2018 and 2021.

In addition, it should continue with the signalled additional capital increases in expenditure from 2019 onwards earmarked from existing fiscal space in the Summer Economic Statement (with some existing space retained for investment in education and innovation in 2018).

Fundamentally, Ibec's view is that the level shift in 2015 represented substantial (if volatile) economic activity. This is very clear from the large boost in corporation tax receipts which followed it. In this respect, the Government's current approach is also internally inconsistent, ignoring the 24.5% potential growth figure but then including the volatile corporation tax receipts from that activity in annual revenues (and spending them). It is likely this inconsistency was ignored as a consistent treatment would have resulted in obliging the Government to introduce significant budget corrections into the medium-term.

In Ibec's view a more consistent approach would be to apply the EC common methodology for estimating potential growth using the 26% growth figure which has been calculated correctly by the official statistics bodies both domestically and in Europe. This would be consistent with the methodology agreed at a European level. Additionally, it would also be internally consistent. The choice is then a political one whether to use that fiscal space in full or not. The Irish Government should take that decision.

Ibec believes that this greater potential fiscal space has been arrived at due to volatility brought on by restructuring in global corporates. A more accurate assessment of the economy would be to support Government use of the greater fiscal space underpinned by corporation tax receipts, which continue to flow from the GDP increase, for much needed one-off public capital projects. This has a dual advantage. Firstly, it allows Ireland to increase its levels of capital expenditure whilst conforming to the fiscal rules and running a current budget which is balanced or in surplus. Secondly, it would avoid the Government building future volatility in corporate tax receipts into the base of current spending (the approach it has taken to date). This would require no significant deviation from the minimum required fiscal adjustment to meet the medium term objective under the fiscal rules (which would be reached in 2019). Exchequer investment in infrastructure would reach 3% of GDP by 2021. The remaining 1% of GDP needed to reach a 4% of GDP target, which Ibec believes the Government should hold, could be filled by PPPs, co-financed EIB investment and recycling of State assets. Gross Government debt would only be in the region of two percentage points higher than in the alternative scenario by 2021 and fall to 64% of GDP.

3 Brexit-proofing the budget

Issue 01

Introduce a Brexit mitigation fund to help firms retool for a post-Brexit world

Brexit involves an unprecedented fracture of the EU Single Market, with Ireland particularly exposed. Indeed, for Ireland it would be no exaggeration to term this decision a force majeure. As such, it is vital that the EU institutions and national Governments recognise the potential for economic disruption and take decisive steps to offset such risks. In order to support businesses, funding should be provided over a three year period to help companies trade through any period of disruption, adapt and succeed into the future. The resources required will be in the region of 5% of the value of current annual export sales to the UK by Irish indigenous firms, or €1.2 billion over three years. This would be funded from both Government and EU sources. These resources, where appropriate, should be available to both exporters and smaller Irish producers which risk being displaced by cheaper UK imports in their home market.

Why?

The impact of Brexit will be felt particularly among firms that are most embedded in the domestic economy. Overall, it is the indigenous sectors of the economy that are most reliant on the UK – with over 40% of their output going there. Despite accounting for only 12% of exports, indigenous exporters spend as much in the domestic economy through purchases and wages as the multinational exporters. They also employ as many people, with even greater regional spread. Agri-food alone spends over €4.3 billion on purchases from primary producers directly, along with a further €2.1 billion on wages of employees who primarily live in rural locations. In the region of 46,000 jobs in the sector are linked directly or indirectly to exports to the UK. The impact of Brexit on the producers of 12% of total exports will be as important for the domestic economy as the fortunes of the producers of the other 88%.

Measures for Budget 2018

In Budget 2018 the Government should:

- Put in place a multi-annual framework for funding Brexit mitigation. Funds should be targeted at supporting innovation, market diversification, upskilling and capital expenditure in equipment and machinery.
- Continue to make the case for the temporary State aid regime allowing for enterprise stablisiation funding to be released for otherwise viable business.
- Introduce medium term measures to allow the Irish Government to introduce investment aids to support Irish companies to invest in measures such as enabling technology, management training, plant renewal and expansion, refinancing, market development and innovation so as to regain competitiveness following single market fracture.
- Introduce trade support measures, including export trade financing and export credit guarantees, to support the continued development of international export markets.
- Retain the 9% tourism VAT rate to keep Ireland competitive with other European destinations and invest in Ireland’s regional tourism infrastructure.
- Make sure that more SMEs can gain access to the online trading voucher by expanding its upper limit on employment to 50 and turnover limit to €10 million.
- Provide more high-quality work space for smaller export orientated firms in partnership with NAMA as office cost increases in our urban centres are crowding out new high-growth start-ups.

Total cost of €150 million in 2018 (with a multiannual commitment to spending at least another €450 million between now and 2020)

Issue 02

Set out a 3 year tax plan to match or better the UK on SME taxation

The importance of entrepreneurs and small business to Ireland's economy cannot be overstated: more than 98% of Irish firms employ less than 20 people, yet collectively these companies employ 44% of the workforce. Unfortunately, this has not been reflected in the tax system - entrepreneurs and the self-employed are subject to more onerous tax treatment than employees. In order to create a truly entrepreneurial culture, focused not just on starting but on scaling businesses, this must change.

Why?

The need to improve the taxation environment for small business has become even more important in the context of Brexit. In the past, only FDI was contestable – that has now changed. A central threat to the Irish indigenous business base is that of Irish companies moving capacity to the UK in order to keep a foothold in their major market. This threat has been heightened by the fact that those companies would receive more favourable treatment when it comes to capital gains, investment taxes and the tax treatment of share-options in the UK. These gaps must be closed in the short-term in order to make sure the best of our growing indigenous sectors do not become contestable.

Measures for Budget 2018

In Budget 2018 the Government should:

- Improve on commitments made with regards to Capital Gains Tax entrepreneurs' relief in the Programme for Government by increasing the lifetime cap on gains from €1 million to €15 million **Cost: €40 million**
- Introduce a preliminary version of the SEIS scheme similar to its UK equivalent. This would remove a barrier to small start-up businesses, while also encouraging first-time investors into the market **Cost: €10 million**
- Introduce a simplified R&D tax credit meaning that smaller firms are better able to overcome funding constraints on their innovative activity **€10 million**
- Review the inequitable stamp duty treatment of shares in Irish owned companies **Revenue neutral in 2018**.
- Introduce an enterprise management incentive scheme for smaller firms. In recent weeks the Swedish Government received European Commission clearance to abolish tax on stock options at companies that are younger than 10 years, have fewer than 50 employees, and revenue and a balance sheet of below €8 million. This should be replicated here. **No immediate cost but rising to between €1 million and €5 million in future years**.

Total cost of €60 million in 2018

Issue 03

Keep consumer taxes competitive

The threat of increased cross-border shopping and black market activity due to Brexit and a more volatile sterling exchange rate means that Ireland will have to keep a careful watch on relative prices for consumer goods. Ireland currently has a significant price differential to Northern Ireland in most categories of consumer goods including food, drink, alcohol and tobacco. Further tax induced price increases should be avoided where possible.

Why?

As it stands, Ireland has some of Europe's highest taxes on alcohol and tobacco. All available evidence suggests we have hit diminishing marginal returns in terms of the tax take from those sources. That is, further increases will lead to losses of revenue. In addition, Ibec remains in fundamental disagreement with the principle of additional food and beverage taxes such as fat and sugar taxes. Further increases in these taxes, at a time of great uncertainty around customs regimes, risks encouraging the development of a mature grey market along the border counties at great loss to the Exchequer.

Measures for Budget 2018

In Budget 2018 the Government should:

- Roll-back on implementation of the sugar tax. If introduced, it should include clear, measurable and specific definitions and common understandings to avoid arbitrage. It should be closely evaluated for cross-border impacts, include a sunset clause and apply equally and consistently to all producers and importers
- Reduce alcohol excise by 3.5% across the board with no level increases to other excises such as fuel or tobacco **€50 million in Budget 2018**
- Don't change existing VAT rates

Total cost of €50 million in 2018

4 Skills and the workforce

Issue 04

Make sure Ireland can compete for high-skilled workers

Ireland must make sure that work pays in order to attract and retain skilled workers within the country. To compete, we must reform our income tax system and adopt a more favourable treatment of stock options.

Why?

International evidence has shown that tax systems with a broad base and low marginal tax rates provide the best outcomes for employers, employees and the economy. The system currently in place in Ireland is the opposite of this - a narrow base with very high marginal tax rates kick in before a person starts earning the average wage. The plans to cut the Universal Social Charge would make this worse and would move Ireland further away from international best practice. The Government should focus on reform of the 49% rate of tax and ensuring that more workers (currently more than half) are not dragged into the higher rate of tax.

Another solution which would help Ireland attract more skilled workers is having a favourable treatment of stock options. Currently Ireland's treatment of these schemes is less favourable than other locations, particularly the UK. In its submission to Government last year, Ibec outlined a number of measures which would make these schemes more attractive. Also, new changes to tax residency rules may mean that foreign employees spending a brief period of time working in Ireland could see PAYE obligations arise even where the person does not eventually become tax liable and these may cause an additional administrative burden and increased costs.

Measures for Budget 2018

In Budget 2018 the Government should:

- Increase the entry point to the 40% rate of income tax by €1,000 to keep ahead of wage growth **Cost: €69 million in 2018**
- Remove USC and PSRI liabilities on revenue approved stock option schemes (€8 million). Reduce the income tax liability of unapproved schemes to the ordinary rate of tax (€20 million). Reform operating constraints in approved schemes so that they are more flexible for companies reward structures €20 million in 2018. **Cost: €48 million**
- Reduce the higher marginal rate of tax for those earning over €70,000 by 1% and commit to reducing the all-in marginal rate for all employees to 47% over the coming years. **Cost: €115 million in 2018**
- Review the recent changes to tax residency rules. New revenue guidance in December on employee payroll tax deductions in relation to non-Irish employment exercised in the State means that where an employee is working in Irish company for more than 30 days Revenue will treat the Irish company as their employer for tax purposes regardless of where their employment costs are borne. In the vast majority of cases the employee will not eventually pay any tax in Ireland. This should be reviewed in light of the administrative costs and cash-flow implications for employees. **Cost Neutral**

Total cost of €232 million in 2018

Issue 05

Fund Ireland's education and training system adequately

The current funding model for higher education is unsustainable. Public expenditure on education fell significantly in recent years. At the same time, student numbers increased and are expected to rise even further as the number of people of college-going age is set to grow. This was recognised in the Cassells Report which highlighted that future funding should come from three sources: employers, students and Government. International experience emphasises the importance of not relying on a single source of funding for higher education. The State, individuals and employers all have a role to play. Therefore the increased Exchequer funding, an effective student contribution mechanism and an employer contribution must happen concurrently as part of an interlocked solution.

Why?

This year, the Government released a consultation on an employer-exchequer funding mechanism for higher education. The proposed measure would involve an increase of 0.3% in Employers' PSRI which would go towards the National Training Fund. This alone would be an inadequate fix as it would address only 5% of total higher education funding. Given the significant financing requirement needed, any increase in employer funding must be accompanied by student payments. The best way for this to be achieved would be through a student loan scheme. Ibec has already called for once-off corporation tax receipts to be ring-fenced for capital spending. Part of these funds should be used for investment in higher education. This would be enough to cover employer contributions and would avoid the need to place an additional distortionary tax on employment, particularly given the pressures from Brexit uncertainty.

Another reason for the lack of capital funding is that, unlike universities, Institutes of Technology (IoT) are unable to borrow without adding to the national debt. By permitting this borrowing, these institutions would be able to develop a funding base and provide the much needed specialised facilities, particularly laboratories for science, computing, industrial design and engineering-related disciplines that are needed to address major skills needs. In terms of the actual use of the National Training Fund, almost 80% of the funds are being used for re-activation programmes. During the crisis, when the unemployment rate was over 15% it was necessary to prioritise this area. However, given the recent fall in unemployment, these funds should be re-directed towards in-work training schemes such as Skillnets and Apprenticeship programmes.

Measures for Budget 2018

In Budget 2018 the Government should:

- Commit to restoring funding for higher education through a commitment to combine employer, student and Government contributions. Follow through on existing pre-committed funding of €53 million announced in Budget 2017 and increase by another €50 million
- Increase overall capital allocations to higher education by €50 million and reinstate funding for the next cycle of Programme of Research in Third Level Institutions (funding included in allocations under Section 6)
- 50% of the National Training Fund should be re-prioritised towards training for those already in employment (e.g. Skillnets and apprenticeships)
- Implement the Institute of Technology Act 2006 which would give IoT's the same access to borrowing as their university counterparts

Total cost of €100 million in 2018

Issue 06

Get more people back into the workforce

Ireland's participation rates are low by international standards, partly due to low female participation - Ireland currently has one of the largest differences between female and male participation rates in the EU. It is no coincidence that childcare costs in Ireland are still amongst the highest in Europe. In Budget 2018, Government should set out a medium-term plan to reduce these childcare costs significantly and bring more people back to work.

Why?

Childcare costs are so high that they reduce the financial incentive to work, particularly for second earners. In other countries, childcare costs are significantly lower as the sector receives a greater amount of Government subsidies. In Ireland, while supports for these services are low, direct payments to parents are amongst the highest in the EU, due to child benefit. However, these payments are poorly targeted. An estimated €330 million of these payments go to households earning more than €100,000. If these payments were used in a more targeted way, it would improve the incentive to work and increase the productive capacity of the economy.

Measures for Budget 2018

In Budget 2018 the Government should:

Means test child benefit payments so that they remain the same for low income households but have these payments taper off gradually for higher income households. This has the potential to save the Government €200-€500 million depending on the avenue chosen. These savings should then be redirected as follows:

- Extend the Early Childhood Care Education scheme to all children over 6 months
- Implement a formal after and before school care system
- Continue the professionalization of the early years' service. In addition to the higher capitation grants, the ratios (i.e. workers per child) should be loosened if the worker in question has a level 7 qualification. This would provide a greater incentive for providers to encourage workers to obtain these qualifications.

Cost neutral in 2018

5 International taxation and the foreign direct investment (FDI) model

Issue 07

Make sure Ireland's corporate tax regime is ready for change

Recent years have seen the advent of the OECD's Base Erosion Profit Shifting (BEPS) which represents the single biggest change in the global corporate tax system in living memory. At a European level we have also seen the re-emergence of Common Consolidated Corporation Tax Base (CCCTB) and Public Country by Country Reporting (CbCR) proposals along with various other tax reforms, and in the US, whilst the outcome is still far from clear, the prospect of corporate tax reform has never been more tangible. In addition, Brexit, a slowdown in global trade, a turn against globalisation and political uncertainty in Europe present threats to Ireland's FDI driven growth model. In the current uncertain global environment, it is imperative that Ireland and Irish business reinforces our story as a clear example of the benefits of globalisation.

Why?

Despite recent challenges, Ireland's model of a small business-friendly open economy within Europe has continued to demonstrate serious substance with continued investment and employment in highly globalised industries. Ibec believes that attracting FDI remains key to Ireland's prospects for high-value employment and economic growth. Ireland has been one of the big winners from globalisation, in part because of its successful, open and business-friendly economic model, which has been the driving force behind Ireland's transformation from the 'sick man of Europe' to one of the world's richest nations in a little over a generation.

Over 50 years of policy focused on industrialisation by invitation has resulted in the location of globally competitive clusters in high-value added sectors within the country. Ireland's economy today is dominated across a number of indicators by the Multinational sector which provides 22% of all private sector jobs, 35% of all wages and 64% of investment. Ireland's corporation tax strategy, while not the sole reason for this success, is a major part of our offering.

Measures for Budget 2018

In Budget 2018 the Government should:

- Re-commit to FDI driven growth mode and the 12.5% corporate tax rate.
- Review the operation of the Knowledge Development Box to ensure it remains ‘best in class’.
- Support the full implementation of the OECD BEPS process. Although there are some concerns at the margin, the overall agreement is well balanced and it has been a singular achievement in multilateral tax reform.
- Stand ready to defend Ireland’s economic interests at home and abroad. In particular the CCCTB poses a real threat to real activity in this country. Although there are notional advantages to a common European tax base, most - if not all - of the aims of the CCTB can be achieved by full implementation of BEPS. The final ‘C’ – consolidation – runs contra to the spirit and wording of BEPS and could see Ireland plausibly lose up to 50% of its corporate tax base to the advantage of lower value creating but larger consumer markets.

Cost neutral in 2018

Issue 08

Improve the R&D tax credit to make sure it remains best in class

The R&D tax credit scheme has become a cornerstone of Ireland's enterprise policy and is essential in driving innovation in indigenous firms and in helping to locate R&D and wider investment into Ireland. Various policy changes have enhanced the scheme over recent years but the ongoing single biggest weakness of the scheme is the uncertainty faced by those businesses availing of it.

Why?

Irish economy-wide R&D spending is equivalent to around 1.6% of GDP; this is compared with an EU average of 2.1% (with leading EU countries spending 3.3%). The R&D tax credit has been a successful model in encouraging 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. Department of Finance research has suggested this spending could be as high as €2.40, with deadweight cost less than half of comparable schemes in the Netherlands. Studies in the UK suggest this additional spend could rise as far as €3.60 in the long-run.

Measures for Budget 2018

Ireland has increased the generosity of its R&D tax breaks over the years, particularly in dealing with the base year period. Recent moves to establish a structured process or clearing house on the R&D tax credit are also welcome but there are still a number of low or no cost items which could improve the attractiveness of the credit:

- Currently there is little or no definitional consistency of what constitutes R&D between grants and other Science Foundation Ireland (SFI) policy and the eligibility criteria used in technical assessments of R&D claims by Revenue-appointed external experts. Improved guidance is needed for technical experts and SFI should have a role in ensuring that this guidance is consistent with wider innovation policy.
- The current audit period of four years is excessively long for many R&D functions which work on projects where staff turnover is high. Additionally, the audit period length adds to the uncertainty that part or all of the credit may be claimed back almost half a decade after the claim was approved. Over 25% of companies surveyed by Ibec on this issue identified this as their most important priority for change.
- Establish a central specialist unit of R&D scheme experts. This is currently the system in place in the UK and it ensures that there is greater clarity and consistency in communication from Revenue officials to industry. The current model of non-specialist advice at a district level results in a lack of consistency in rulings and guidance to industry which is a source of great frustration to companies claiming the relief.

Cost neutral in 2018

6 Investment priorities

Issue 09

Increase the Government's infrastructure spend with a mix of Exchequer and private finance

Public investment is falling well short of levels necessary to meet the economic and demographic pressures facing the country. The Summer Economic Statement (SES) contained a welcome change in tone on this front, showing more purpose to match the prudence. It is still likely, however, that more may eventually need to be done to meet demographic pressures. Delivering on the ambition shown in the SES is now the challenge. The path towards this should begin in Budget 2018. In order to meet a 3% of GDP Exchequer financed investment target by 2021 Government will need to increases annual capital expenditure by over 20% per annum from 2018 (see Section 2). The remainder should be financed by a mix of public-private partnerships, other non-Exchequer finance such as the European Investment Bank and disposal of underutilised State assets

Why?

Putting in place proper 21st century infrastructure is crucial to making sure that Ireland maintains its place in an ever more competitive global environment. Over recent years Ibec has consistently drawn attention to a lack of ambition when it comes to the Government's delivery of key infrastructure. In the early years of the crisis, this was unfortunate, if understandable, in the context of Ireland's fiscal position. Today it is unwarranted. Ireland is a 21st century economy with a rising population without sufficient infrastructure to match:

- Substantial investment will be needed over the coming decade to refurbish the 19th century network of water infrastructure serving our cities and towns;
- There's no mystery to the regular A&E crisis in hospitals: bed capacity is at 40% of 1980 levels (34th per capita of 41 OECD countries) despite 1.3 million extra people in the country;
- The most recent census figures showed that we are building less than one net new house for every seven new households formed;
- Business in rural areas lacks the basic broadband infrastructure necessary to take full advantage of an economy which is becoming increasingly digital;

- Over 60,000 additional school places will be needed over the next four years while 950 prefabs remain in use in our primary and second-level schools.

Failure to act will slow growth, while increasing pressure for current spending on 'sticking plaster' solutions which cost more in the long run.

Measures for Budget 2018

In Budget 2018 the Government should:

- Set out a clear path to achieving Government infrastructure spending of 4% of GDP by 2021 including achievable targets for EIB funding
- Allocate additional funding of €5.2 billion in Exchequer infrastructure spending for the years between 2018 and 2021 (see section 2)
- Set out a clear deal flow of infrastructure projects in order to attract and maintain interest from international banks and investors in Irish PPP projects. The PPP pipeline is running dry.

€500 million in additional allocation to Exchequer capital spending in 2018 (with a fiscal space allocation of €190 million due to 4 year capital smoothing under the Fiscal Rules).
A commitment to use addition fiscal space as outlined in Section 2 for investment over the coming years.

Issue 10

Make better use of existing assets

The Irish Government currently has in the region of €100 billion of physical and €15 billion of financial assets on its books. Beyond this, resources such as licensing and natural resources are worth significant sums. Making better use of these assets should be a priority for any Government but in many cases information retained on value, availability and use of assets is opaque or even non-existent. Overall improved use of Government assets could yield significant potential dividends to be re-invested in much needed infrastructure.

Why?

The UK, along with Austria, New Zealand and Sweden, is one of the few countries that produce a national balance sheet of its public assets. These make clear the value, yield, and performance of Government-owned assets annually. These and various institutional arrangements, such as sovereign wealth funds, have reduced political interferences and improved dividends from assets significantly freeing up cash for re-investment.

Measures for Budget 2018

In Budget 2018 the Government should:

- Strengthen the information base for investment decision-making by introducing a public National Asset Register in line with best practice in the UK, detailing all assets of Government, local authorities or State bodies.
- Identify assets which are either underutilised or not strategically important which could be used for re-investment in much needed capacity.
- Allow external parties to challenge the use of sites where they are not being used in an efficient way. They should be able to force the State to use it or lose it in the same way as the current system operates in the UK.

Cost neutral in 2018 (funded from within existing Departmental headings).

Issue 11

Invest in innovation

In 2014 (the latest figures available), total R&D spending across the economy was equivalent to 1.6% of GDP. This compared to an EU average of over 2%. Government spending on R&D was 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. Ibec continues to believe that the revised target of 2% of GDP, set under the Lisbon Agenda and restated in Innovation 2020, should be the aim for Ireland over the long-run. This will be difficult to achieve if we do not begin to keep up now with private sector growth. Commitments on the Government side to develop a State R&D and Innovation Infrastructure must be met over the medium-term if business R&D is to meet its side of the bargain.

Why?

The benefits from investing in R&D are long term and a key factor in driving sustainable economic growth. 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.

Measures for Budget 2018

In Budget 2018 the Government should:

- Develop the research landscape to fully exploit the commercial opportunities, a strategic investment of €40million in a Research and Technological Organisation (RTO) model is required over a five year period, to support next phase innovation in advanced manufacturing. To initiate the process to develop the RTO model in 2018, operating costs are estimated to be €1m.
- Reinstate funding for the next cycle of the Programme of Research in Third Level Institutions (PRTLI) to build on existing capacity and capability within the higher education institutions. Higher education expenditure on research (HERD) needs to increase by up to 50% by 2020 for Ireland to reach the 2.5% research intensity rate.
- Grant funding of €21.5m to Science Foundation Ireland to initiate the four research centres, approved by international peer review, to enhance research and development in strategic areas including: dairy technology, mapping molecular human disease, immunology and biopharmaceutical manufacturing.
- Ensure the National Cybersecurity Centre continues to have the resources and expertise adequate to its role as the national Computer Security Incident Response Team.

Total cost of €70 million in 2018

Appendix 1

A1 Summary of recommendations

Issue 1: Introduce a Brexit mitigation fund to help firms retool for a post-Brexit world

Issue 2: Set out a 3 year tax plan to match or better the UK on SME taxation.

Issue 3: No increase in consumer taxes

Issue 4: Make sure Ireland can compete for high-skilled workers

Issue 5: Fund Ireland's education and training system adequately

Issue 6: Get more people back into the workforce

Issue 7: Make sure Ireland's corporate tax regime is ready for change

Issue 8: Improve the R&D tax credit to make sure it remains best in class

Issue 9: Increase the Government's infrastructure spend with a mix of Exchequer and private finance

Issue 10: Make better use of existing assets

Issue 11: Invest in innovation

Appendix 2

A2 Fiscal space calculations

Item	Fiscal space available, €
Gross adjusted fiscal space (incl discretionary revenue)	2,100
Additional fiscal space for investment (as outlined in section 2)	400
Total	2,500
	2018 Cost, €
Pre-existing commitments (incl health, education, housing & demographics)	800
Net fiscal space	**1,700**
Public sector pay	200
Carry-over from measures introduced in 2017 (Tax)	175
Carry-over from measures introduced in 2017 (Expenditure)	475
Net fiscal space remaining	850
Ibec Budget 2018 measures	
	2018 Use of fiscal space, €
Ibec Budget 2018 measures tax	340
Ibec Budget 2018 measures current spending	320
Ibec Budget 2018 measures capital spending	190 (funding 500 of increased spending)
Total	850

Notes

Notes

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