IBEC

Recovery through Enterprise

IBEC Budget Submission 2011

Table of contents

Executive Summary

The Irish economy remains at a very difficult juncture. A loss of momentum in global economic recovery is likely to weigh somewhat on Ireland's prospects for growth. Slower than anticipated growth has significant implications for the adjustment path for the public finances and has raised renewed concerns internationally about Ireland's ability to resolve its own difficulties. Policy measures have continued to focus largely on the financial and fiscal parts of the economy, with little focus on the real economy. The traded sector of the economy will continue to drive recovery and there are some things which Government can do to support this but there must now be more concentration on stimulating domestic demand as this is the more employment intensive sector. IBEC has two overarching priorities for Budget 2011: credible progress must be made on the fiscal position and substantive measures must be introduced to address the jobs crisis.

IBEC has to date largely supported Government's efforts to stabilise the public finances and it recognises the need to remain committed to the adjustment path agreed with the EU Commission. The scale of the adjustment in Budget 2011 will need to be a minimum of €3 bn. However, Irish householders should be given certainty around the scale of the Budget adjustment as soon as possible, and the split of the Budget package between taxation and expenditure adjustments should also be flagged. A combination of domestic uncertainty around the ultimate cost of the banking resolution measures and the reaction of the international markets to this, has clearly dashed the confidence of Irish consumers in recent months. This lack of confidence is resulting in less spending; lower business activity; and ultimately further jobs losses. IBEC believes that by giving consumers the confidence to return to more normal spending and saving patterns, economic activity would receive a much needed boost over the coming months. Government must therefore strike the difficult balance of making an adjustment which is large enough to maintain international credibility but is not so excessive that it further erodes domestic confidence and consumer spending.

IBEC accepts that some tax increases will probably be needed in December's Budget. To date, however, the balance of the adjustment in the public finances has been excessively on the taxation side. Taxation increases in Budget 2011 should therefore not exceed 30% of the total adjustment package. Government is right to progress efforts to restore Ireland's eroded tax base but it must also be mindful that an excessive tax burden will be counter-productive in its efforts to balance the books. From a labour taxation perspective, it must also be sensitive to the potential impact on Ireland's ability to attract and maintain the mobile skilled labour set needed to support the knowledge economy. While the income tax base in Ireland remains fairly narrow, the marginal income tax rates have become uncompetitive in international terms and there is no room for further increases. The reduction needed in current expenditure should be delivered through productivity and efficiencies rather than through cuts in services.

Budget 2011 must deliver innovative solutions to address the jobs crisis. A national internship programme of ambitious scale is urgently needed to stop our talented graduates from emigrating. Labour market policies need radical reform and activation measures must ensure that participants are kept close to the jobs market – we must avoid an over-reliance on 1980s-type social employment schemes. Reskilling initiatives are also urgently required in order to avail of employment opportunities in some sectors. Many companies continue to report unfilled vacancies in areas such as sales and technical roles and a more flexible approach to training, which is more in tune with developing market needs, is urgently needed.

1. Summary of recommendations

Economic reform agenda

- Ireland has regained significant competitiveness over the past two years but in areas such as wage costs and energy further improvements are needed. We remain about 20% more expensive than the UK for most business input costs and closing this gap must be a priority for Government policy
- Administered wages (National Minimum Wage (NMW); Joint Labour Committees (JLCs); Registered Employment Agreements (REAs)) are currently an obstacle to competitiveness adjustment. The NMW should over time be adjusted to the EU 15 average, while the presence of the NMW means that the JLCs and the REAs are no longer of relevance and should be removed
- The unemployment crisis must be at the top of the agenda for all policy makers. Every new Government policy or legislation must be 'jobs proofed'
- Re-energise supports provided for indigenous enterprise. In particular, greater support is needed to support marketing initiatives for SMEs

Fiscal adjustment in Budget 2011

- IBEC supports a fiscal adjustment of a minimum of €3 bn in Budget 2011
- It is accepted that €1 bn of this will come from a reduction in the public capital investment programme
- Of the remaining adjustment no more than €600 mn should be on the taxation side and the balance should come from reductions in current expenditure
- An independent fiscal policy council should be established immediately

Taxation priorities

- Government must continue to commit to Ireland's 12.5% corporation tax brand
- There should be no further increase in the marginal rate of income taxation as it would damage Ireland's ability to attract mobile high skills and would provide a strong disincentive to work
- VAT and excise duty should not be increased as they are already high by international standards and any change could lead to a resumption of large scale cross-border shopping and accelerate the level of smuggling that already exists in the Irish market
- The current Non-Principal Private Residence charge should be increased from €200 to €400 annually – this would raise €80 mn in additional revenue
- A new property tax on residential property should be rolled out as soon as possible, although this may not be feasible for 2011
- Downward indexation of income tax credits in line with wage trends is required to raise the necessary taxation revenue targeted for 2011. A 6% deindexation would raise about €550 mn in a full year
- Tax relief on personal pension contributions should not be changed until a full impact assessment is carried out
- Existing anomalies around the threshold for the health levy should be addressed
- Supports for employee financial involvement should not be diluted in the process of introducing a new universal social contribution
- Employers' PRSI costs are causing competitiveness problems for Ireland and the system needs to be amended via introduction of a cap or a tiered reduction in rates
- A new expat income tax credit is required in order to make Ireland attractive for the mobile specialist skills needed to deliver the smart economy
- Greater flexibility is required in how the R&D tax credit is treated for accounting purposes
- High electricity costs remain a key element of Ireland's competitiveness disadvantage - a portion of the carbon tax must be ring-fenced to help reduce electricity costs for business and to offset the impact of rising Public Service Obligation costs

Current expenditure

- A comprehensive economic assessment of the return on investment across all areas of current expenditure is required in order to provide a solid evidence base for further expenditure reductions
- Productive investment in areas such as education and training; R&D; labour market and enterprise supports must be excluded from general cutbacks

Education and skills investment

- The overall vote for education and skills should not be reduced. However, there should be renewed focus on cost-effective solutions, including the flexibility of the teaching contract, that yield the best returns on investment and improve the effectiveness of the system
- All current revenue generated through the national training levy should continue to be made available for training purposes, with an appropriate portion being dedicated to the provision of additional in-employment training programmes
- A radical reform of junior cycle teaching methods and curriculum should be expedited. The National Council for Curriculum Assessment should receive specific funding to start the process

Addressing the jobs crisis

- The unemployment benefit system should be reformed in order to ensure that a strong incentive remains for all beneficiaries to seek employment
- The Public Employment Service requires urgent reform - at a local level, there should be complete integration of welfare payment and employment services in one-stop shops. Employment service officers should be responsible for taking claim details, monthly signing-on, initial sanction decisions, as well job-search monitoring, employment counselling and job-brokering
- The Employer Job (PRSI) Incentive Scheme applying to jobs created in 2010 should be extended to 2011
- The Work Placement Programme should be scaled up
- A strong national graduate internship programme is needed and should be supported by dedicated bursaries and links with higher education institutions
- A tailored reskilling initiative is needed in order to address labour shortages which remain in the economy. In particular, sales vacancies are going unfilled while a range of IT related skills shortages also remain

2. Priorities for economic recovery

2.1 Global economic outlook

The global economy has returned to reasonable growth during 2010 but considerable risks remain to the overall economic outlook. Much of the recovery has been due to Government stimulus packages in the developed economies. These are now being removed and in many cases are being replaced by a range of austerity measures. Consumer demand, in Europe in particular, is set to remain weak for some time yet. The initial stages of recovery in the US have been relatively robust, but there are now signs that the recovery is running out of steam and growth in 2011 is set to be somewhat slower than that in 2010. US consumers remain fairly nervous while continued weakness in the housing sector is also set to drag on growth over the coming years.

The eurozone sovereign debt crisis has abated somewhat in recent months but the underlying problems have clearly not gone away and further pressure on the eurozone may well emerge in the short to medium-term.

Overall, the global economy is in much better shape than it was during 2009 but the legacy of the worst global recession since the 1940s continues to present a series of threats. Global trade has recovered strongly during 2010 but consumer spending remains weak in most developed economies.

2.2 Prospects for domestic economy

Ireland is now very much a two speed economy – with many firms in the largely multinational dominated export sector benefiting from the strong recovery in global trade, while firms reliant on the domestic economy continue to experience falling activity. The export sector has performed strongly in the first half of 2010 and although the recovery in the global economy may weaken somewhat in 2011, international demand for Irish goods and services should remain fairly robust. A significant improvement in competitiveness, brought about by nominal cost adjustments, improved productivity and euro depreciation has strengthened Ireland's export performance.

Continued weakness of demand and the impacts of price deflation have resulted in difficult trading conditions for firms selling in the domestic market. The nominal size of the domestic Irish economy – GNP in money terms – has fallen by 25% since the start of the recession and continued to decline in the first half of 2010. The turnover of businesses in the retail sector has fallen by over 25% since the start of the crisis, while activity in the construction and related sectors continues to decline, albeit at a somewhat slower pace than during 2009. Although some domestic businesses have seen a modest recovery in activity during the first half of 2010, the level of turnover remains substantially below where it was three years ago.

Despite the risks to the global economic recovery mentioned above, it is expected that the Irish recovery will gain some momentum into 2011. Partially as a result of the unprecedented declines experienced right across the economy over the 2008-2010 period, it is expected that growth in the region of 2.5% will be recorded in 2011. All sectors are likely to see stabilisation and, for most, ultimately moderate recovery during 2011. The level of economic activity of course will remain well down on that recorded prior to the crisis. It is expected that the nominal level of activity in the domestic economy will not return to the 2007 level until 2015 or 2016. The Irish economy is therefore moving out of recession but a number of major challenges remain. The public finance correction is set to be a multiannual process; the unemployment crisis could well remain with us for a decade; the fallout from the economic crisis on many Irish businesses will continue for a number of years; and significant problems remain in our financial system. There is some evidence that the Irish economy is now moving in the right direction – but given the difficulties that remain it is no time for complacency for politicians or policy makers.

2.3 Priorities for economic recovery

In addition to the immediate fiscal and economic priorities for 2011, the upcoming Budget must also lay down some markers in relation to a more medium-term recovery strategy for the Irish economy. The following are some of the economic reform priorities which Government must begin to address in Budget 2011 and through other policy measures:

- **Jobs crisis – every policy measure from taxation to legislative reform and expenditure decisions must be 'jobs proofed':** the unemployment crisis must be at the top of the agenda for all policy makers. Every Government decision must be assessed against the question 'what impact will this have on employment?'. The way we educate; how we invest in training; the level of our regulated wages; how Government impacts on the cost of doing business; the structure of the social welfare system; how we are allocating scarce resources must all be fully re-examined with a view to what the likely impacts on employment are. Every Government policy measure should be accompanied with a detailed analysis of its impact on employment.

- **Competitiveness issues – progress made but lots more to do, energy and many pay costs remain the key issues**: Many of Ireland's regulated wage rates (National Minimum Wage (NMW); Joint Labour Committee (JLC) rates; Registered Employment Agreements (REAs)) are very high by international standards, particularly against the UK and are a major stumbling block in Ireland's efforts to regain competitiveness. The NMW must over time revert to the EU-15 average. The JLCs and the REAs are antiquated systems and are no longer needed given that we have a NMW – they should be abolished immediately. Our public sector wages also remain high by international standards, despite the reductions in recent years[1]. For some occupations, such as medical consultants, remuneration levels in Ireland are about double the average across the EU 15[2] – this is clearly unsustainable and must be addressed.

  Electricity costs in Ireland have been reduced significantly since 2008 but much of the reduction has been due to temporary factors such as falling gas prices, falling demand caused by the recession and a consumer rebate. Business is very concerned that increases in electricity prices will again place Ireland at the top of the EU cost table. This would be a major blow to our international competitiveness and would be very damaging for both the viability of indigenous enterprise and Ireland's attractiveness for FDI. Government must also recognise that any further increases in other energy costs (such as transport fuels), through increased carbon taxes or otherwise, would severely hinder the competitiveness of Ireland's export sector.

  While progress has been made over the past two years in addressing Ireland's competitiveness position, we still remain about 20% more expensive for a range of business inputs against the UK. Getting our cost base down to that of our nearest competitor must be a priority for Government.

- **Get serious about labour market reform**: extensive research from the OECD and elsewhere has shown that Ireland's labour market activation policies are outdated. Reform to date has been largely cosmetic and a radical overhaul of structures and systems is now needed – the quality and level of interventions for the unemployed remains totally inadequate. Incentive to work issues have become a major issue in the labour market. Ireland is one of the few developed countries which does not distinguish between short and long-term social welfare replacement rates. At present a typical head of household in receipt of welfare benefits requires a gross salary of €35,000 to €40,000 in order to have a financial incentive to take up a job offer – this situation must be urgently addressed.

- **We need a medium-term view on appropriate taxation and expenditure levels**: since the economic collapse, some commentators have argued that Ireland's tax burden is too low and that in future higher taxes will be needed to fund the delivery of public services. IBEC believes such a policy would be detrimental to our enterprise and employment base. It is clear that some rebuilding of the tax base is needed but there is no evidence to suggest that the future overall tax-take needs to be higher than it was prior to the crisis. Government should articulate its views on what it sees as the appropriate level of taxation and expenditure for the Irish economic model. IBEC believes Ireland's appropriate tax burden (Government revenue as % of GNP) is about 36%-38%, this is similar to the tax burden in countries such as Canada and Australia (which provide world-class public services), while the current expenditure target should be about 32% of GNP.

- **Develop a strategy for debt reduction and examine the policy implications of this**: in relation to the public finances management, we remain in 'fire-fighting' mode. The first job is to return the budget deficit to less than 3% of GDP but Government also needs to start planning a long-term debt reduction strategy. National debt post crisis will most likely exceed 100% of GDP. A debt burden over 90% or

[1] ECB. *Public wages in the Euro Area, towards securing stability and competitiveness*. Occasional Paper Series. No. 112 / June 2010.
[2] National Competitiveness Council. *Cost of doing business in Ireland 2010*. July 2010.

so is damaging to an economy's growth potential[3], making it vulnerable to any adverse economic shocks. Ireland also has debt level obligations under the Stability and Growth Pact, so Government must plan to reduce the debt level to the euro zone target of 60% over time.

- **Supporting indigenous enterprise – we need a radical rethink**: Ireland has a poor track record in supporting indigenous entrepreneurship. The FDI sector is critically important to our economic future but its development must go hand-in-hand with a stronger performance by the indigenous enterprise sector. A domestic entrepreneurship strategy which would examine issues such as financial incentives; support of state agencies; education; bankruptcy and other legislative issues is urgently needed.

- **Properly evaluate where current spending goes**: the annual budgetary process tends to focus excessively on the marginal spending changes (either upwards or downwards) from the previous year. The McCarthy report attempted to provide a broader assessment of the value for money of the entire block of current spending but as an exercise it was both time and resource constrained. A more quantitative evaluation of the entire current expenditure budget is required in order to assess the return on investment right across all areas of Government expenditure. Future expenditure adjustments could therefore be more evidence based and the overall socio-economic benefits from public expenditure should be maximised.

[3] See for instance Reinhart, Carmen M and Kenneth S Rogoff (2010), "Growth in a Time of Debt" *American Economic Review,* May.

3. Fiscal policy priorities

3.1 Introduction

IBEC supported and continues to support the need for speedy, effective and credible action to correct the government finances. The magnitude of the adjustments taken to date has been significant and there has been general acceptance in Ireland of the need for such corrective actions. The measures taken have been recognized internationally and have contributed to maintaining the confidence of foreign investors in Ireland. In the light of "unexpected adverse economic events with major unfavourable consequences for government finances," the Commission issued a new recommendation in April 2010 to correct the deficit by 2014 rather than by the original 2013. It is our opinion that the planned deficit reduction schedule agreed with the Commission should be adhered to.

3.2 Scale of adjustment

The uncertainty surrounding global economic growth, its impact on Ireland and the difficulty in assessing the magnitude of government injections into the financial sector make quantification of the evolution of government finances particularly hazardous. However, recent papers by the IMF and the ESRI provide a reasonable assessment on which to make some judgements. As we perceive that most of the risks are likely to lie on a more adverse outcome than was proposed in the projections for 2011 and beyond in Budget 2010, it seems prudent that the adjustments outlined in that document should be pursued with vigour and probably are a minimum. There should be some contingency planning for a scenario that may turn out to be less benign.

It is likely that without corrective action, the underlying deficit would have risen to 25% of GDP and be totally unsustainable. The accounting treatment of certain financial sector supports has already raised the deficit to over 14% of GDP in 2009 and raises the deficit to over 20% in 2010. These are stark figures and though they may not count in the underlying deficit for Stability and Growth Pact measurement, they do still impact to the detriment of the economy, attract the attention of the rating agencies and raise interest payments on the debt.

We said at the time of the Budget that the government's financial projections were based on an optimistic scenario through to 2014. The IMF has voiced a similar concern in its Country Report, July 2010, suggesting that the deficit by 2014 may only reduce to 5.9% of GDP rather than the 2.9% target of the Government. The ESRI under the low growth scenario suggests the deficit could still be as high as 4.1% of GDP in 2015. Analysis by the ESRI points to the impact that a high level of deficit and debt have on the interest rate premium charged on government debt. If a lower level of borrowing reduces the interest rate paid on government bonds, which in turn leads to a reduction in real interest rates charged to businesses and consumers, then there are benefits from early fiscal correction and costs from delay. Indeed the positive impact of a reduced interest rate premium may well increase domestic activity, thus offsetting much of the deflationary impact of fiscal consolidation.

3.3 Priorities for Budget 2011

Evidence of the benefits from early fiscal correction indicate that the adjustment programme of €3 billion in 2011 should be at least met in full. IBEC accepts the reduction of the capital programme by €1 billion to €5.5 billion as it does the ongoing commitment to maintain this level of investment. The appropriate mix between expenditure and taxation for the €2 billion current adjustment should be 70% expenditure reduction and 30% revenue raising. International evidence suggests that reducing expenditure is less damaging to economic growth than tax increases. The balance of the adjustment to date in the public finances has been excessively on the taxation side and Budget 2011 must redress this somewhat by targeting a larger portion of the adjustment on current expenditure.

IBEC therefore recommends that the remaining €2 bn adjustment should comprise of €1.4 bn in current expenditure reductions and some €600 mn in taxation increases. The detailed measures required to achieve these adjustments are set out in the subsequent sections.

3.4 New model needed for fiscal policy oversight

One of the second round effects of the global financial crisis of the last two years is the laying bare of the inadequacies of the economic governance system for the 16 euro zone members. The crisis has clearly shown the limitations of the current Stability and Growth Pact (SGP) in either enforcing discipline or of highlighting the risk of instability in a timely way that could have prevented it. It was deficient because although it had a rules-based approach regarding allowable levels of deficits and debt, it concentrated mainly on the deficit for which there was corrective action (the excessive deficit procedure). It did not focus on the sustainability of debt levels. More importantly, it had no role to play in preventing the build-up of macroeconomic imbalances of the kind that gave rise to the collapse of tax revenues in Ireland when the bubble burst.

The Commission has said that there was not enough commitment to fiscal consolidation, in particular during good economic times. In some Member States, revenues were temporarily boosted by tax-rich activity, driven by unsustainable booms in housing, construction and financial services. It would appear particularly important to detect asset price booms and excessive credit growth at an early stage to avert costly corrections of fiscal and external balances at a later stage.

Businesses across Europe are seriously concerned that the heightened uncertainty brought about by the threat of sovereign default by Greece and the subsequent financial stress are harming business planning while rising public debt is crowding out companies' access to finance and raising the prospect of significantly higher taxes in the future. There are supporting proposals from the European Commission for greater surveillance.

The Commission is seeking to bring the successor to the Lisbon Reform Agenda, *Europe 2020,* into a more prominent position with a view to achieving a more integrated surveillance of economic policies. In order to prevent the occurrence of the severe imbalances in the euro area that we have witnessed in recent years, there is a need to deepen the analysis and expand economic surveillance beyond the budgetary dimension to address other macroeconomic imbalances, including competitiveness developments, with a view to facilitating a policy driven adjustment at national level.

The Commission seeks to go further than *Europe 2020,* by proposing to upgrade the existing but ineffective peer review of macroeconomic imbalances into a structured surveillance framework for the euro area. It recommends keeping a scoreboard on external and internal developments that would indicate the need for corrective action in specific member states. It further suggests that warnings and recommendations from the European Systemic Risk Board (yet to come into operation), to prevent excessive credit growth or exuberant asset price developments, would also be considered a matter of common concern resulting in peer pressure for remedial action.

By pulling all these differing aspects of surveillance together under what it terms a European Semester, the Commission proposes there should be a simultaneous assessment of both fiscal and structural policies in each EU member state with country specific recommendations. IBEC is supportive of such an approach as a reform agenda with some teeth is a mechanism to ensure that member state economies develop towards more economic convergence and reverse falling competitiveness, which underlies the build up of imbalances that give rise to current account deficits.

Whether these European proposals come into being or not, the experience of the last decade suggests that a new approach to budgetary policy in Ireland is needed which would inject an independent economic expertise into the budgetary process. This is not to usurp the democratic process of economic policy formulation but to subject it to independent economic analysis that would take a longer term view than the electoral cycle permits and would assess policy in the context of competitiveness, macroeconomic imbalances and the constraints imposed by membership of the euro area.

To ensure compliance and informed national debate, an independent Fiscal Policy Council along the lines of the Swedish Fiscal Policy Council should be established, staffed by small group of specialists, including one non-national. Particular focus should be on long term sustainability. The reason for including a non-national on the Council would be to ensure that an external expert would bring an added independent thought process to the deliberations of the Council. In particular, it is highly likely that such a Council could have played a significant stabilising role in the fiscal policy formation of the last decade.

4. Restructuring the tax system

4.1 Tax structure and mix

In order to reconcile the gap between Government revenue and expenditure, there must be some changes to Irish taxation policy over the coming years. The fallout from the economic crisis, however, does not mean that all aspects of the current taxation system are in need of change. Much of the taxation policy adopted over recent decades remains appropriate for the Irish economic model of a small open economy with a strong FDI presence. We must continue to recognise that competitive tax rates for the most mobile factors of production such as enterprise and labour, ultimately yield higher tax revenues to the Exchequer. Government must also recognise, however, that in some aspects the Irish taxation system is out line with tax policy internationally and these differences must be addressed.

Since the outset of the crisis Government has regularly stated its support for the current corporation tax regime. In addition to the economic rationale for having a competitive corporation tax rate in a small open economy, Government also recognises the 'brand value' of Ireland's headline corporation tax rate. In order to retain the current volume of FDI and to remain successful in attracting new mobile investment, Government must remain fully committed to keeping the headline rate of corporation tax unchanged.

Prior to 2008, labour taxes in Ireland were regarded as relatively low in international terms. OECD analysis shows that the income tax burden on higher paid workers in Ireland was about average but the effective tax rates on lower income workers were among the lowest in the OECD. Over recent budgets, the tax burden on workers earning above average wages has been increased significantly and the marginal rate of income tax now stands at 52%. This is high in international terms (higher than the US; UK or Germany) and makes Ireland a less attractive location for mobile labour. The income tax burden at the lower end of the earnings spectrum remains relatively low and there is some potential over time to move this closer to the international average.

The most significant difference between Ireland's tax system and those in other countries is the lack of any meaningful taxes charged on property in Ireland. Taxes on property are least damaging to economic growth. IBEC therefore believes that the majority of the taxation shortfall over the coming years should be addressed through the introduction of property taxes and local charges. We also accept, however, that for the purposes of meeting the fiscal adjustment target for 2011 it may not be feasible to have a fully operational property tax system. Work should begin immediately on the implementation of a residential property tax and increased household charges, for their introduction in subsequent budgets. These taxes should be introduced as early as is practically possible and their likely nature and shape should also be communicated by Government well in advance of their introduction.

As an interim measure to the introduction of a comprehensive property tax system, the existing Non-Principal Private Residence charge should be doubled from €200 to €400. This would yield additional tax revenue of about €80 mn for 2011.

IBEC believes that the current system of indirect taxation is largely appropriate and that there is no potential to raise revenue in a manner which is not damaging to the economy and employment. The VAT rate in Ireland is at the upper end of the EU scale and any further increases would be likely to result in falling revenues to the Exchequer. Although the level of cross-border shopping is not as high as it was during 2009, the Irish retail market remains highly sensitive to future indirect tax and currency changes. Cross-border shopping cost the Exchequer about €500 mn in 2009 and it would be highly counterproductive to increase either VAT or excise rates in Budget 2011. A further €556mn was lost to the Exchequer by people deliberately avoiding high price tobacco products in legitimate retail channels in Ireland by making their purchases in other countries or on the black market. A 20% reduction in this activity would save the Exchequer €110mn.

4.2 Income tax

Income tax rates and credits

Ideally it would be preferable to postpone any income tax increases until the labour market was showing firm signs of recovery. Unfortunately, however, income taxes present the only practical option for sufficient additional tax revenues in Budget 2011. The marginal rate of tax is already too high and cannot be increased further. The Budget must therefore focus on broadening the income tax base in an effort to bring some of the 40% to 50% of income earners who currently do not pay any income tax, into the tax net. This is most effectively done through downward indexation (deindexation) of the tax credits system. A 6% downward adjustment of the personal and PAYE tax credits would yield about €550 mn p.a. This would result in an average annual tax increase of about €300 per worker or €6 per week. No other changes should be made to the existing income tax rates.

Tax relief on pensions

In both the Renewed Programme for Government and the National Pensions Framework, Government has stated its intentions to replace the existing tax relief available for personal pension contributions with a single relief rate of 33%. For those currently paying tax at the higher rate this will result in a reduction of about one-third[4] in the incentive to provide for a pension. It is inevitable that such a reduction in the fiscal incentive to save for a pension will impact on contribution rates. Worryingly, the behavioural impact of such a major change to pension tax relief system has not been modelled. Government has indicated its intention to make this policy change without any underlying evidence base. In addition to the concerns about the likely decline in pension contributions for those taxed at the marginal rate as a result of the changes, there is no evidence to suggest that those taxed at the standard rate will increase their contributions as a result of the introduction of a new uniform tax relief rate.

There are also a number of other difficulties which need to be considered in advance of such a policy change. A lower tax relief rate on personal pension contributions could mean that pensioners would pay a higher tax rate on pension income than the relief they earned on contributions. Such a scenario would be a major disincentive to saving for a pension. Consideration is also required on the implications for self-employed and other workers who have left it late in their careers to save for a pension. Removal of the current level of tax relief could therefore damage existing plans for pension provision by such individuals.

IBEC supports the objective to provide an equal rate of relief for all income earners saving for a pension. It is concerned, however, that the current proposals have been poorly thought out and lack any real evidence base. It is therefore recommended that the proposed changes should not be introduced in the absence of detailed research of the likely behavioural response on pension savings rates of those workers who currently receive relief at the higher rate. Government must also recognise that in cases where existing personal contribution rates are maintained, the change will result in a cut to after-tax income. Introduction of such a change at a time of wage reductions and other additional tax increases would be very problematic for both employees and employers.

4.3 Levies and a new universal social contribution

The Minister for Finance indicated in his 2010 Budget speech that Government would introduce a new universal social contribution in 2011 to replace employee PRSI, and the health and income levies. This represents a major change to the tax system and will present a series of implementation challenges for employers and Revenue. It is essential that a sufficient lead time is provided to allow employers plan for these implementation challenges.

Introduction of the new system should take into account the following issues :

- **Ensure all existing anomalies are removed**: as a result of the current health levy threshold, which is set at €26,000, a worker earning €27,000 gross income actually receives lower net income than one earning €26,000. This has provided a series of difficulties for both employees and employers. Any new social charge system must ensure that such anomalies are eliminated.

- **The charge should not be revenue raising:** the purpose of the new charge should not be to raise revenue for the Exchequer; the level of revenue raised should be linked to the level of benefits paid out. The new charge should not result in an increased marginal tax rate at the higher end; as mentioned earlier, the marginal tax rate cannot be increased further.

- **Greater proportionality between payments and benefits**: Ireland's social insurance system is based on two key principles – the contributory principle and the social solidarity principle. The contributory principle means that those who pay social security contributions while at work establish entitlements upon retirement, in the event of illness or other circumstances. The social solidarity principle is somewhat of a contradiction to this, however, as it means that there is no actuarially defined link between the amount of contributions paid by an individual and the benefits available. The Irish system,

[4] Relief is currently granted at the 41% marginal rate of tax also against PRSI and other levies.

therefore, attempts to provide additional benefits to those who pay PRSI while at the same time supporting redistribution within society.

- Upon retirement those who have made sufficient PRSI contributions receive the contributory pension which is about 10% higher than the non-contributory State pension. For many employees the benefits obtained from the Social Insurance Fund (SIF) are miniscule in comparison to the contributions that their employers and themselves have made over their working lives. The current social insurance model has become as much an additional form of taxation as an insurance system for those who contribute to it. The current system provides limited incentive for workers to remain in the formal economy – the benefit advantages of paying taxes are not strong. In order to counter the rapid growth of the informal economy in recent years, it is necessary to provide a stronger fiscal incentive for those workers who pay their taxes. The contributory principle should be strengthened in the new universal social contribution. Government should commit to increasing the differential between the contributory and non-contributory pensions; unemployment benefit should be increased for periods of short-term unemployment; and recent reductions to other benefits (such as dental) should be restored. Given the current funding difficulties facing the Social Insurance Fund, these changes may take some time to implement but should be signalled as early as possible.

- **Support for employee financial involvement**: any change to the existing employee PRSI system must ensure continued fiscal support for the range of employee financial involvement schemes which Government has backed in recent years. Apart from Revenue approved employee share plans, under existing legislation employee share incentives are taxable at an employee's marginal rate of income tax along with the new income levy. However, share-based remuneration is not currently liable to social security charges. One of the effective incentives consistently maintained by Government in this area has been the fact that employee share-based rewards have remained outside the scope of PRSI.

  Any proposal that would increase company costs and reduce employee reward will be seen to be negative in terms of Ireland's attractiveness for FDI and may cause potential employee relations difficulties as employees seek compensatory knock on wage increases. It is well established internationally that companies which have implemented employee share incentive plans, as part of a performance related total reward philosophy, outperform those companies which do not. Ireland is recognised internationally for its commitment to encouraging employee share ownership and this is well reflected in the growth of employee financial involvement, in both indigenous companies and in the FDI sector. The extension of social security charges to share-based remuneration would have the negative effect of further increasing the tax wedge, would act as a disincentive for employees to achieve the collective business objective and add further to employment costs in the form of increased employer PRSI. Any potential dilution of the current exclusion from a social security charge would cause many existing companies to reassess the cost effectiveness of such arrangements and is also likely to discourage new organisations from rolling out broad based employee share plans in the future.

  IBEC believes that an extension of a social security charge to all forms of share-based remuneration would therefore be counter-productive and would seriously undermine the progress which has been made in broadening the level of employee financial participation at the level of the enterprise.

Employers' PRSI

The introduction of the new universal social contribution also necessitates a review of the current system of employers' PRSI. There is a general perception that employers' PRSI in Ireland is lower than similar employer social security charges in other developed countries. Data from the OECD Taxing Wages database, however, show that this is not the case. The headline rate of employers' PRSI at 10.75% is relatively low in international terms but the Irish system disadvantages employers in two main ways. Firstly, unlike many other countries, there is no cap on the employers' contribution and secondly, the flat rate applies to all income, whereas in many other countries a reduced rate applies at higher income levels. The Irish system of employers' social security therefore becomes less competitive at higher wage levels (Table 4.1).

Table 4.1 Employers' social security charges at different income levels, 2009.

	€60,000	€80,000	€100,000	€120,000
Ireland	**6,450**	**8,600**	**10,750**	**12,900**
Austria	12,173	12,173	12,173	12,173
Germany	10,431	10,977	10,977	10,977
Netherlands	4,996	4,996	4,996	4,996
UK	6,765	9,325	11,885	14,445
US	5,001	6,455	6,745	7,035

Source: OECD. Taxing Wages, 2009.

Table 4.1 shows that the employers' social security charge is the third lowest in the selected countries at a gross wage of €60,000 but rises to the second highest at a gross wage of €120,000. For those businesses employing higher skilled employees in sectors such as financial services; pharmaceuticals; medical devices; and ICT; it is clear that Ireland has become a relatively high cost location for total labour costs. A number of other countries have reduced employers' social charges in recent years and Ireland has become a less attractive location for investment. The employers' social security contribution for an employee earning €120,000 is now nearly double that in the US; two and a half times that in the Netherlands and about 20% higher than that in Germany. When these figures are grossed up to a plant level for a company's total workforce the cost disadvantage of an Irish site can run to many millions.

IBEC believes that the current system of employers' PRSI is therefore a significant cost disadvantage and in particular is an obstacle to the attraction of high quality employment. The system needs to be restructured so that it is less penal on higher skilled employers. This should involve either the reintroduction of a cap on contributions or a tiered system with greatly reduced rates applying at about €60,000 and again stepping down at about €100,000.

4.4 Tax and the Smart economy

In order to ensure delivery of the Smart economy objectives it is essential that Government commences implementation of the tax changes recommended by the Innovation Taskforce. In the upcoming Budget IBEC believes that Government should prioritise the following issues in order achieve maximum economic and employment returns from the scarce resources available:

- **Improvements to R&D tax credit scheme**: this scheme has proved highly effective in increasing firm-level investment in R&D in Ireland. However, the scheme has three major shortcomings which should be addressed in Budget 2011:
    1. Flexibility in relation to use of credit: the operations of many multinational companies in Ireland have been unable to get the full value of the scheme due to the fact that the credit was generally accounted for 'below the line' at a group level[5]. It therefore did not help reduce the cost base of the Irish operation or the cost of doing R&D in Ireland. This represents a significant lost opportunity in addressing the high cost of doing business in Ireland. Over the past year or so some of the large accountancy firms have indicated to their clients that the credit could be taken 'above the line' and treated similarly to an R&D grant and therefore reduce costs in the Irish operation. However, there is not a consensus among the firms as to the appropriate accounting treatment of the credit and many multinationals continue to account for it below the line. Budget 2011 should therefore introduce the necessary legislative change which will allow multinationals the flexibility to treat the credit as either an 'above the line' or 'below the line' item, through either an 'accounting solution' to the problem or via an offset against employers' PRSI. This would have no additional cost for the Exchequer and would deliver significant economic and employment benefits.
    2. Increase the outsourcing cap: the scheme currently limits the outsourcing of R&D from businesses to research institutes to just 5%. This greatly limits the degree to which enterprise can collaborate with universities on R&D activity and is inconsistent with other Government policy aimed at fostering linkages between the two sectors. Budget 2011 should increase this outsourcing cap to 25%.

[5] See IBEC survey of firms on accounting treatment of R&D tax credit. August 2010.

3. Flexibility in base year: the credit is provided on incremental R&D spend over that recorded in the designated base year of 2003. For a number of companies which had exceptionally high R&D investment in 2003, the scheme therefore provides no incentive for R&D activity. By allowing companies the flexibility to choose their base period from a number of years i.e. 2003 to 2005 or to use their average annual R&D spend over the 2003 to 2005 period, this problem could be easily addressed at very low cost.

- **Intellectual Property (IP) taxation regime**: Ireland's IP offering remains a crucial part of the suite of measures needed to attract FDI and sustain indigenous investment and employment. Developments in the IP taxation regimes in competitor countries means that Ireland can quickly become a less favoured location for investment. Government should continue to monitor the competitive standing of Ireland's offering and ensure that it remains top of class.

- **Support for entrepreneurship**: the Irish tax system currently provides no incentives for entrepreneurs selling a business to invest some of its proceeds in other enterprise activity. Such a 'roll-over' type relief was removed a number of years ago. The Innovation Taskforce report has recommended its reintroduction in order to support investment in innovation start-ups. There is a strong rationale, however, to provide such an incentive for general investment in enterprises by entrepreneurs and other high net worth individuals. Budget 2011 should also introduce a state-agency backed model for angel investments which would involve matching, promotion and tax incentives. As a result of ongoing credit access difficulties SMEs and start-ups are finding it increasingly difficult to source investment and the angel investor model offers considerable potential in an Irish context.

- **Make Ireland more attractive for mobile skills**: a central part of the successful expansion of the smart economy in Ireland is the ability of firms based here to attract some specialist skills for key roles. Typically, substantial additional employment is then supported by the location of such individuals in the Irish operation. In order for firms to successfully do this, it is essential that Ireland is seen as an attractive location to live and work in. The personal taxation regime is a key influencer of this. As a result of the significant increase in the income tax burden over the past couple of years, Ireland now a comparatively high effective income tax rate for high skilled workers and much higher than in countries such as the US; UK; Switzerland; and Netherlands. In addition to this, many other countries offer much more attractive ex-pat taxation regimes. Ireland's urgently needs to introduce a new ex-pat taxation regime targeted at those specialist skills needed to deliver the smart economy. Budget 2011 should introduce a scheme similar to that operating in countries such as the Netherlands or Finland. The Dutch scheme offers special tax regimes for expats with certain skill sets, level of education or income levels. In effect, 30% of income is exempt from tax, therefore significantly reducing the effective income tax rates for eligible workers.

- **Ensure tax system supports mobile investments such as film industry**: while IBEC supports the restriction of tax reliefs in the Irish tax system, there are a small number of cases where economic rationale supports their continued use. Support provided for mobile investment such as the film industry is one. IBEC therefore supports the retention of the existing reliefs under Section 481. Without this relief, Ireland will no longer be an attractive location for film production and much needed high quality employment will be lost to competitor locations.

4.5 Carbon tax and electricity prices

Energy costs are a major concern for business in the current economic context. Costs in Ireland remain high in international terms and are a major source of Ireland's competitiveness disadvantage. Moving into 2011 there are several upward pressures on energy costs being faced by business including the carbon tax and an increase in Public Service Obligation (PSO) levies. Both these pressures are related to meeting government policy on deployment of renewables and meeting climate change targets. The carbon tax is a market signal to mitigate greenhouse gases by encouraging the uptake of energy efficiency and renewable energy. The PSO is a market support to certain renewable and indigenous energy sources.

IBEC has long argued that revenue from the carbon tax should be recycled and used to offset costs to business while addressing the need to mitigate climate change and support renewable energy deployment. A carbon tax solely designed to act as a market signal to assist the deployment of renewables is only another cost to consumers if energy costs are relatively inelastic and no tax revenue is recycled to lower labour costs or support energy efficiency and renewable energy initiatives.

In the context of developing a greener economy, IBEC believes that some carbon tax revenues should be used to visibly lower labour costs and support the PSO components for necessary renewable energy deployment rather than add further cost in the form of PSO levies to business. The contribution of fossil-fired combined heat and power (CHP) to energy efficiency and climate change objectives has been largely overlooked in the debate on the development of a greener economy. IBEC believes that incentives will be needed to support the outcomes for CHP envisaged in the 2007 Energy White Paper.

5. Reforming current expenditure

5.1 Approach to current expenditure adjustments

Budget 2011 will require a reduction in public current expenditure of at least €1.4 bn or 2.5%. IBEC's view on how the expenditure adjustment should be calibrated is based on the following principles:

- Where possible, service levels should not be diluted – savings should be achieved through a reduction in unit costs arising from increased productivity and efficiency right across the public sector
- Across the board flat rate cuts should not be implemented. The return on investment, from both a social and economic perspective, should be examined in each area of expenditure – as has been done in the case of capital investment – and spending decisions should be adjusted accordingly.
- In particular, IBEC believes that spending reductions should not be implemented in areas of productive investment which are supporting enterprise and employment and ultimately economic recovery. Key strategic investment areas include:
    - Education and training
    - Research and development
    - Labour market activation
    - Enterprise support

In order to make the adjustments in a manner which is least damaging to the economy, Government needs to conduct a comprehensive assessment of the socio-economic return of each expenditure area. The budget process typically focuses on the marginal adjustment in current spending from year to year and there is little or no assessment of the return achieved by the different areas in the entire block of current spending. The McCarthy Report has attempted to examine the potential for savings right across the different areas of current spending but the process was limited by both time and resource constraints. A more detailed economic assessment is now required, however, of the entire current expenditure budget. This should examine which areas of spending deliver the best return on investment from a socio-economic perspective. For example, at present we have no metrics to indicate the relative return from investment in the greyhound industry compared to that from spending in pre-school education. All future budgetary decisions should have a stronger evidence base. There is, therefore, a need for a thorough review of the totality of current expenditure including an evaluation of the need for specific services, the efficiency of their delivery and whether that delivery would best be achieved through the use of private sector service providers.

5.2 Supporting productive investment

Knowledge Transfer for the *Innovation Island*

A successful innovation ecosystem relies on the interlinking of all stakeholders. Ireland's innovation strategy should facilitate co-operative networks to facilitate knowledge sharing and foster a culture of risk taking. This would involve activities that transgress traditional business boundaries and greater collaboration with higher education institutions. Continued support for the technology transfer offices coupled with the effective implementation of a knowledge brokerage system for industry can lead to sustainable growth and increased productivity, while at the same time allowing Ireland to become a global hub for IP creation and exploitation.

The Innovation Taskforce made a number of recommendations regarding knowledge transfer, incorporating the need to facilitate networking and the need to better communicate supports on offer. These recommendations need to be implemented at the earliest opportunity and include:

- Development of an IP protocol
- National internship/work experience scheme
- Promote/reward an entrepreneurial culture in Higher Education Institutions
- Commercialisation metrics should be agreed and standardised across Government
- A single branded interface for all funding and programme delivery
- Facilitate access of companies to specialised equipment/laboratory space within HEIs.

Technology transfer offices (TTOs)
The Forfás review on the supports for the exploitation of IP emanating from publicly-funded research in the higher level sector (May 2010) stressed that that while Ireland is making good progress and achieving value for money in terms of IP commercialisation, the country could be doing better. The review stressed that knowledge-transfer, not commercialisation, should be the over-arching priority.

In order to increase the level and quality of intellectual property transferred from research in HEIs into companies in Ireland, Enterprise Ireland supports the identification, protection and transfer of IP through the TTOs. The current Technology Transfer Strengthening Initiative under Enterprise Ireland expires in 2011. There needs to be certainty about its renewal and a commitment to incorporate necessary changes identified by the Innovation Taskforce and the Forfás review to improve the effectiveness of the scheme.

While improved support from Enterprise Ireland would result in anchoring the TTO structure in HEIs, the potential for centralising and/or outsourcing the back office functions, where appropriate, of the TTOs should be explored. This will ensure that technology transfer offices are adequately resourced to effectively carry out their role of capturing research results for economic benefit, as an integral part of the research environment.

Knowledge transfer partnerships
The Innovation Taskforce set out a number of principles that are required to improve the innovation environment, including the central role of entrepreneurs and a sharp research focus to target areas of potential economic advantage. However, a critical weakness of the national innovation ecosystem remains, namely the need for a national knowledge transfer service between Irish-based enterprises (indigenous and MNCs) and third level research institutes, connecting businesses to the world-class knowledge and expertise available.

Companies, particularly SMEs, currently lack the scale and institutional network to commercialise the research produced at third level. While TTOs within academic institutions have an important role, international evidence suggests that business-education knowledge transfer partnerships are more likely to occur through the support of industry networks. They also require a high degree of personal contact. Existing models for such a matchmaking service include the Irish Software Innovation Network (run by IBEC with support from Enterprise Ireland) and Interface in Scotland. These highly effective low-cost models could be extended to other key industry sectors (e.g. agri-food, financial services, medical devices, pharma etc). It would also facilitate research and commercialisation of convergent technologies. The UK, the US and South Africa are pursuing similar initiatives to improve the R&D and innovation capacity of their indigenous enterprise base.

The principal focus of an industry knowledge transfer network is to develop structured demand-led partnerships between industry and the research establishment. To ensure that relevant matches are achieved, the network would be neutral and would help to find the most relevant matches and provide better use of resources.

The network would not replace but complement the work of the TTOs and would be an industry driven service. For example, the network will work with TTOs and research institutes to identify high potential research, and then facilitate industry collaboration to develop feasibility studies, market research and product prototypes. The network would consult directly with TTOs to identify relevant technology solutions for network member companies and inform them of industry perspectives on key issues. It would also provide a single-point-of-contact for the TTOs in their direct contacts with industry.

Recommendations:

- The recommendations of the Innovation Taskforce relating to knowledge transfer, mechanisms to facilitate networking/collaborative relationships and the need to better communicate and deliver supports on offer should be implemented immediately
- Government support for the Technology Transfer Offices needs to be re-confirmed as well as a commitment to incorporate necessary changes to improve the effectiveness of their operation
- Government must address a critical weakness of the national innovation ecosystem, namely the need for the creation of a national knowledge transfer service between Irish-based enterprises and third level research institutes, connecting businesses to the world-class knowledge and expertise available.

5.3 Education and skills

Ireland's economic recovery is contingent on a world class education and training system. This does not imply that education can be exempted from the consequences of the need for ongoing fiscal adjustment. It does mean, however, that we should avoid damaging cuts to education budgets, while also increasing focus on cost-effective solutions that yield the best returns on investment, improve the effectiveness of our system and ensure excellent outcomes.

Early childhood education
The Early Childhood and Education Scheme (ECCE) was a welcome initiative in a strategically important area where early intervention can result in substantial socio-economic benefits. However, if it is to be effective, it must be must be based on accredited professional and pedagogical practices informed by international best practice. Therefore it is critical that investment in the scheme is afforded the highest priority.

Primary and secondary level
As globalisation, technology and other factors change the nature of the skills required in the economy, we need to ensure that our education system responds in terms of what it teaches and how it teaches. Teacher quality and curriculum reform affect student performance more than any other factors. Today's economy demands not only a high-level of competence in the traditional academic disciplines but also what might be called 21st century teaching and learning skills. For example, it is critical that curricula promote the importance of reasoning, critical thinking and generic skills that are so important for maximising life chances in the labour market and outside it.

Even more important than the curriculum is, in Betrand Russell's words, 'the question of the method of teaching and spirit in which the teaching is given'. Continuous professional development (CPD) by teachers is the key dimension of ensuring quality outcomes for the student population and Ireland performs very poorly in this regard. According to the OECD's Teaching and Learning Survey (TALIS) in 2009, Irish teachers participated in 5.6 days development in the previous 18 months compared with a TALIS average of 15.3 days.

There have also been some welcome developments in curriculum reform and teacher development. For example the new Project Maths curriculum reform has been supported by € 5mn investment in teacher CPD in 2010. However, given the significant shortage of suitably qualified mathematics teachers, rolling investment of at least €7 mn per year up to 2018 will be required to ensure that teachers who do not hold a major qualification in mathematics can avail of post-graduate programmes in order to deliver the curriculum effectively.

In April 2010, the Tánaiste and Minister for Education and Skills launched a consultation process on reform of the junior cycle in second level schools. IBEC believes that radical reform of junior cycle teaching methods and curriculum content could have a profound impact on education outcomes including the development of critical thinking and moving away from the dominance of rote learning. According to the ESRI[6], a move to 'personalised learning' (i.e. allowing young people to combine different learning experiences at a pace which suits their needs, interests and abilities) could also have a positive impact on early school leaving (see below). Therefore it should be regarded as a priority area for policy attention and investment.

IBEC welcomes the allocation of €265 mn to the ICT in Schools programme in the revised Investment Infrastructure Priorities (2010-2016). However it notes with concern the slowdown in releasing the initial €150m recommended by the Joint ICT Advisory Group to the Minister of Education and Skills. Significant progress has been made since the launch of this initiative in November 2009 but business is concerned at the absence of a solid 'road map' to measure progress.

Recommendations

- The overall vote for education and skills should not be reduced. However, there should be renewed focus on cost-effective solutions, including the flexibility of the teaching contract, that yield the best returns on investment and improve the effectiveness of the system
- A CPD framework for secondary teachers, adapting good practice from business and the best performing education systems, should be developed by the Teaching Council and the Department of Education and Skills
- A rolling investment of at least €7 mn per year up to 2018 should be put in place to ensure that teachers who do not hold a major qualification in mathematics can avail of post-graduate programmes in order to deliver the new Project Maths curriculum effectively
- A radical reform of junior cycle teaching methods and curriculum should be expedited. The National Council for Curriculum Assessment should receive specific funding to start the process
- A detailed 'road map' to measure the progress under the ICT in Schools programme is required. A centralised procurement model to ensure value for money should also be developed

[6] *No Way Back? The Dynamics of Early School Leaving*, by Delma Byrne and Emer Smyth (ESRI, 2009)

- Investment in the Early Childhood and Education Scheme (ECCE) must afforded the highest priority. An early review of the scheme should be conducted to ensure that it conforms to professional and pedagogical practices that are informed by international best practice.

Third and fourth level

The long awaited strategic review of the Irish higher education had not been published at the time of writing. In the absence of this report, IBEC reiterates its call for an 'investment needs' analysis to determine the funding required to enable Irish institutions to develop Centres of Excellence. Greater specialisation and amalgamation of courses among Irish higher level institutes is also required to develop critical mass.

The ongoing debate about the equity of students contributing to their third level education (through fees, a graduate tax or repayable income contingent loans) has tended to obscure the requirement for a funding strategy that will enable the higher education sector to enhance its contribution to society and the economy. That strategy needs to encompass measures to deal with immediate requirements as well as overall structural reform.

Recommendations

- An investment needs analysis should be published as part of the higher education strategic review.
- Income from a new funding model for higher education should not be offset against reductions in state funding and should represent a real funding increase for third level education.
- Third level funding should be based on the principle of cost sharing between the State and students. It should be based on a universal loan system, with income contingent repayments.
- An urgent review should be undertaken of the existing Student Services Charge regime and Higher Education Grants Scheme to ensure the sustainability of the system in the short term.
- The funding model should not discriminate against part-time students and graduates who wish to pursue further studies.

Training for people in employment

In order to ensure smooth entry of individuals into labour markets and transition between different jobs, policy coherence across government is required. The allocation of responsibility for skills development policy to the new Department of Education and Skills earlier this year should enhance the enterprise focus of higher education and vocational education committees, which have a crucial role to play in developing the skills of those at work and those looking for a job. It should also break down the artificial and archaic distinction between "education" and "skills".

However it is important that this broader and more complex remit is not lost amongst the Department's competing priorities. While the National Skills Strategy (2007) was published in a different economic context, its overall principles and objectives remain relevant. Lack of employment opportunities may be pushing up education retention rates but it is important that the skills that are acquired will enable individuals to enter and remain in the labour market.

The continued diversion of the National Training Fund from in-company training (to the point where it now accounts for less than a quarter of the Fund's current allocation and significantly less than this if support for apprenticeships is excluded) is also a source of concern. While some re-prioritisation of government spending must occur, the importance of state-funded in-employment training is not diminished. By providing funding for in-employment training, the State leverages significant matched private sector funding through co-funding models. This funding is particularly important for stimulating demand for in-employment training amongst cohorts of firms and employees that might otherwise remain disengaged from the training system.

It should also be noted that a significant proportion of the revenue that is raised annually through the national employment training levy remains unspent and reverts to the Exchequer in the form of the National Training Fund surplus. At the end of 2009, this surplus was €205 mn. Given the need to boost the skills of those in employment and to improve the stock of skills in the workforce, this revenue should be made available for training purposes.

Recommendations

- The Department of Education and Skills should publish an implementation plan for the National Skills Strategy which reflects the changed economic circumstances but also provides for State support for in-employment training.
- All current revenue generated through the national training levy should continue to be made available for training purposes, with an appropriate portion being dedicated to the provision of additional in-employment training programmes.

6. Employment strategy priorities

6.1 Introduction

As a result of the recession, unemployment has shot up to 13.2% in Q2 2010, according to the Quarterly National Household Survey from the CSO, while the broadest measure of labour supply (including the unemployed and those outside the labour force showing some interest in obtaining work) stands at 17%. Ireland is clearly experiencing an unemployment crisis.

The degree to which direct Government intervention can create employment in the economy is very limited. Crucially, however, Government policy has a major impact on the conditions which are conducive to firms rehiring and on the quality of education and skills of those seeking employment. Restoring competitiveness in areas such as energy and wage costs is central to a labour market recovery. Government must also ensure that there is a strong incentive to work and that the optimum approach is taken to assist and up-skill those who are looking for work. At present, Ireland's labour market structures remain totally inadequate to cope with the unemployment crisis and urgent reform is required.

6.2 Incentive to work

Recent developments in the labour market have heightened the need for social welfare reform in Ireland. A key issue is the reduced incentive to work resulting from significant real increases in social welfare rates, falling wages and higher taxes on labour.

The Irish system is somewhat of an anomaly among OECD countries. Many countries provide higher benefits for the initial period of unemployment. In many cases these higher levels of benefit are subject to participation in education or training. After the initial period of unemployment, benefits are reduced in order to provide a strong economic incentive for the unemployed to return to work. In contrast, there is no difference in Ireland between short-term and long-term replacement rates. A series of OECD and other reports have been critical of the lack of withdrawal of welfare benefits in Ireland. In particular, the OECD has pointed out that Ireland is the only country in the OECD where single parent welfare benefits are provided until children are 18. The structure of Ireland's welfare system means that there is no financial incentive for many long-term unemployed to seek employment.

While Ireland does not rank as highly for short-term net replacement rates, for long-term replacement rates Ireland is near the top of the league table. Net replacement rates for long-term unemployment in Ireland (one-income family with two children at 100% of the average wage) have increased from 64% in 2001 to 77% in 2008. Ireland ranked just after Norway (78%) but above Finland (75%) and Sweden (65%) in terms of generosity of the replacement rate. The OECD points out that higher replacement rates usually involve stricter activation measures and higher levels of spending on active labour market programmes than is the case in Ireland. It is clear that, at a time of low unemployment, the relative improvements in the level of benefits did not go hand in hand with reform of the activation system.

In order to promote a strong incentive to work, one area of review should be the Family Income Supplement (FIS). This supplement aims to provide support to those with dependents who enter employment. However, the current application procedure is cumbersome and this may be one of the reasons for the historically low take-up rates for FIS.

Recommendations

- The unemployment benefit system should be reformed in order to ensure that a strong incentive remains for all beneficiaries to seek employment
- Short-term replacement rates should be increased and long-term replacement rates reduced in order to provide a more effective and efficient interface between the social welfare system and the labour market
- Family Income Supplement should be reformed to provide a greater incentive to those with dependents to enter employment

6.3 The Public Employment Service

In order to minimise labour market scarring, Ireland must overhaul its activation model and increase resources in line with the rise in demand for public employment services.

The reform should be based on a strong evidence base. Research[7] suggests that job search assistance programmes have a positive short-run impact (over a one-year horizon), while benefits of classroom and on-the-job training programmes become evident over the medium term (after two years). Evidence from the Netherlands[8] shows that reductions of the unemployment benefit, for instance in cases of non-compliance with job search criteria, can be effective in stimulating transition from welfare to work.

The OECD[9]has pointed out that job search incentives in Ireland need to be strengthened. Benefits should be conditional on participation in activation schemes – for instance, claimants should be required to show evidence of job search, attend frequent interviews with employment counsellors, apply for vacant jobs, comply with other instructions and implement a personal action plan. However, this is predicated on an adequately resourced and properly integrated public employment service.

Ireland has a very low rate of interview and referrals for unemployment claimants by international comparisons. However, it is undeniable that the sharp rise in unemployment has by far outpaced the allocation of resources to employment services. Finally, there is a gap in the Irish activation model in that there is no agency with responsibility for preparing candidates for job search (including CVs, interview skills and job matching). While FÁS provides some of these services there needs to be a strong focus on these vital job-seeking tools. In the UK, the government promised almost £1.3 billion to the Job-centre plus "Rapid Response teams". These groups liaise directly with employers to provide information, advice and support to workers who are being made redundant. More needs to be done to support Irish workers in this regard.

Another area of reform relates to the provision of information. At present, the unemployed have to trawl through a number of agencies and websites to ascertain their full entitlements and obtain information. The provision of a one-stop-shop for the provision of information to the unemployed would provide a far more efficient system for both jobseeker and for the state agencies. FÁS or another dedicated agency needs to act as the first point of contact or the gateway agency and bring under its umbrella information about all options available. Career and progression opportunity from a range of agencies needs to be provided, whether these opportunities are from FÁS, Skillnets, VEC, IOT, universities or private agencies.
These measures are predicated on a fully integrated and adequately resourced public employment service (PES). As Grubb[10] has pointed out: 'an increase in expenditure on the PES, devoted to activation measures, may pay for itself several times over through reduced benefit expenditures and several times again through increased tax and social insurance contribution receipts'. The recent transfer of responsibility for FÁS Employment Services to the Department of Social Protection provides an opportunity to integrate income supports with the use of employment service by social welfare recipients. IBEC believes that change should be implemented immediately.

Recommendations

- Placement and counselling institutions, currently split across three departments and four funding channels should be integrated to ensure that employment services have enough resources to engage with unemployed clients systematically and not only with those who self-present.
- At a local level, there should be complete integration of welfare payment and employment services in one-stop shops. Employment service officers should be responsible for taking claim details, monthly signing-on, initial sanction decisions, as well job-search monitoring, employment counselling and job-brokering

[7] Card, D., J. Kluve, and A. Weber (2009), "Active Labour Market Policy Evaluations: a Meta-Analysis", IZA Working Paper 4002, Bonn.
[8] Van der Klaauw, B and JC van Ours (2010), "Carrot and Stick: How Reemployment Bonuses and Benefit Sanctions Affect Job Finding Rates", CEPR Discussion Paper 7924.
[9] Grubb D, S. Singh and P. Tergeist (2009), "Activation Policies in Ireland", OECD Social, Employment and Migration Working Papers No. 75, www.oecd.org/els/workingpapers.
[10] Grubb, D., (2010) 'Perspectives from the Review 'Activation Policies in Ireland.' Prepared for the Labour Market Roundtable meeting

6.4 Activation programmes

Labour market activation programmes are another important aspect of a policy response to combat structural unemployment. Ireland has experience of active labour market programmes (ALMPs) going as far back as the very difficult labour market conditions of the 1980s. There has also been systematic evaluation of the effectiveness of ALMPs in Ireland which should be used to inform new initiatives in this area.

The Economic and Social Research Institute (ESRI)[11] has concluded that programmes that are close to the market are more likely to enhance the employment prospects of participants than programmes with weak market linkages. Similarly, it suggests that employment subsidies which are designed to place participants in real jobs in the marketplace, will be more likely to result in work experience and skills learned on the job. These are likely to be closer to those in demand in the labour market than work experience or skills learned while participating in direct employment schemes on projects which, by their nature, are not viable in the market.

On the positive side, the OECD has argued that marginal employment subsidies can be a cost effective way of strengthening job creation in the early phases of recovery. The Employer Job (PRSI) Incentive Scheme applying to jobs created in 2010 is a useful way of reducing the cost on the employer of taking on new staff, while targeting resources at net job creation and those who have been unemployed for a substantial period of time. The scheme should be extended to 2011.

The government's work placement schemes have been also been a positive initiative and should be scaled up.

IBEC is particularly concerned at the implications for new graduate employment which represents both a high social cost and a serious potential loss of human capital. For this reason, it has been a strong advocate of graduate internships. For businesses, graduate internships are a good way to attract talent for a specific time period or project. For graduates, these schemes can provide an important opportunity to kick-start their career. IBEC's experience with its own small GradLink internship has highlighted a number of issues that need to be addressed if the Government wants to introduce the type of scaled-up national internship programme that the Confederation would strongly favour. Firstly, there needs to be greater flexibility around payment. Many new graduates who live at home are entitled to no, or very low, social welfare payments and companies are prevented from providing any top-up to help defray the costs associated with attending such programmes. A properly constituted bursary scheme, jointly funded through the social welfare system and by participating companies, could help to address this.

Secondly, the legal status of internships needs to be clarified so that there is no ambiguity about the rights and responsibilities of graduates and sponsoring companies. And, finally, there should be stronger links with third level education institutions to help to define the learning outcomes and provide accreditation for the internship programme.

The sub-group of young persons with below Leaving Certificate qualifications is also a particular source of concern. Over 40% of this group were Not in Employment, Education, or Training (NEETs) in 2008. These young people are disproportionately likely to have experienced problem owing to a range of issues including special educational needs, poor attainment at school, health problems, disabilities or parents who are themselves unemployed. This means an effective strategy needs to join up different parts of the public services to provide the variety of supports they need. For example, the UK government has introduced youth guarantee scheme which promises that young people who have been unemployed for a period of time will be guaranteed either a job or a place in the education system.

Recommendations

- The existing Community Employment (CE) programme should not be expanded greatly. Programmes should be close to the market, as they will be more closely related to the actual skill demands of the labour market
- Significant resources should be allocated to a more intensive labour market activation programme. Benefits should be conditional on participation in the scheme – for instance, require claimants to show evidence of job search, attend frequent interviews with employment counsellors, apply for vacant jobs, comply with other instructions and implement a personal action plan
- The Employer Job (PRSI) Incentive Scheme applying to jobs created in 2010 should be extended to 2011
- The Work Placement Programme should be scaled up

[11] Employability: The Impact of Activation Measures. Philip J. O'Connell, ESRI (2002)

- Develop a strong national graduate internship programme, supported by dedicated bursaries and links with higher education institutions
- A systematic referral channel for early school leavers should be put in place between the Education Welfare Board and the new integrated employment placement and counselling service recommended above
- Attainment of education qualifications, whether they be the Leaving Certificate or other Level 4/5 qualifications should be a core objective of Youthreach.

IBEC is the voice of Irish business and employers both nationally and internationally. It is the umbrella body for Ireland's leading business and industry groups and associations. IBEC represents more than 7,500 member organisations, of all sizes, in all regions and across all industry sectors.

With acknowledged expertise in all aspects of business representation, policy development, employee relations, human resources, employment law, environment, health and safety, trade and EU affairs, IBEC is uniquely positioned to provide indispensible, tailored advice to members. To learn more, contact IBEC on **www.ibec.ie**

IBEC MISSION

IBEC promotes the interests of business and employers in Ireland by working to foster the continuing development of a competitive environment that encourages sustainable growth, and within which both enterprise and people can flourish.

IRISH BUSINESS AND EMPLOYERS CONFEDERATION

Confederation House 84/86 Lower Baggot Street Dublin 2
PHONE + 353 (0)1 605 1500 FAX + 353 (0)1 638 1500
EMAIL info@ibec.ie **www.ibec.ie**

CORK
Knockrea House
Douglas Road
Cork
PHONE + 353 (0)21 429 5511
EMAIL info@ibec.ie

SOUTH EAST
Confederation House
Waterford Business Park
Cork Road Waterford
PHONE + 353 (0)51 331 260
EMAIL southeast@ibec.ie

MID-WEST
Gardner House
Bank Place
Charlotte Quay Limerick
PHONE + 353 (0)61 410 411
EMAIL midwest@ibec.ie

WEST
Ross House
Victoria Place
Galway
PHONE + 353 (0)91 561 109
EMAIL galway@ibec.ie

NORTH WEST
3rd Floor Pier One
Quay Street
Donegal Town
PHONE + 353 (0)74 972 4280
EMAIL northwest@ibec.ie

IBEC EUROPE
Avenue de Cortenbergh, 89
Boite 2 1000 Bruxelles,
Belgium
PHONE + 32 (0)2 512 3333
EMAIL ibec.europe@ibec.ie
www.ibec.ie/europe