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Fiscal policy and redistribution in Ireland

TCD-ESRI conference in honour of Patrick Honohan's contribution to Irish economic policy

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Fiscal policy matters

This paper explores one aspect of fiscal policy: the role it plays in shaping the distribution of resources

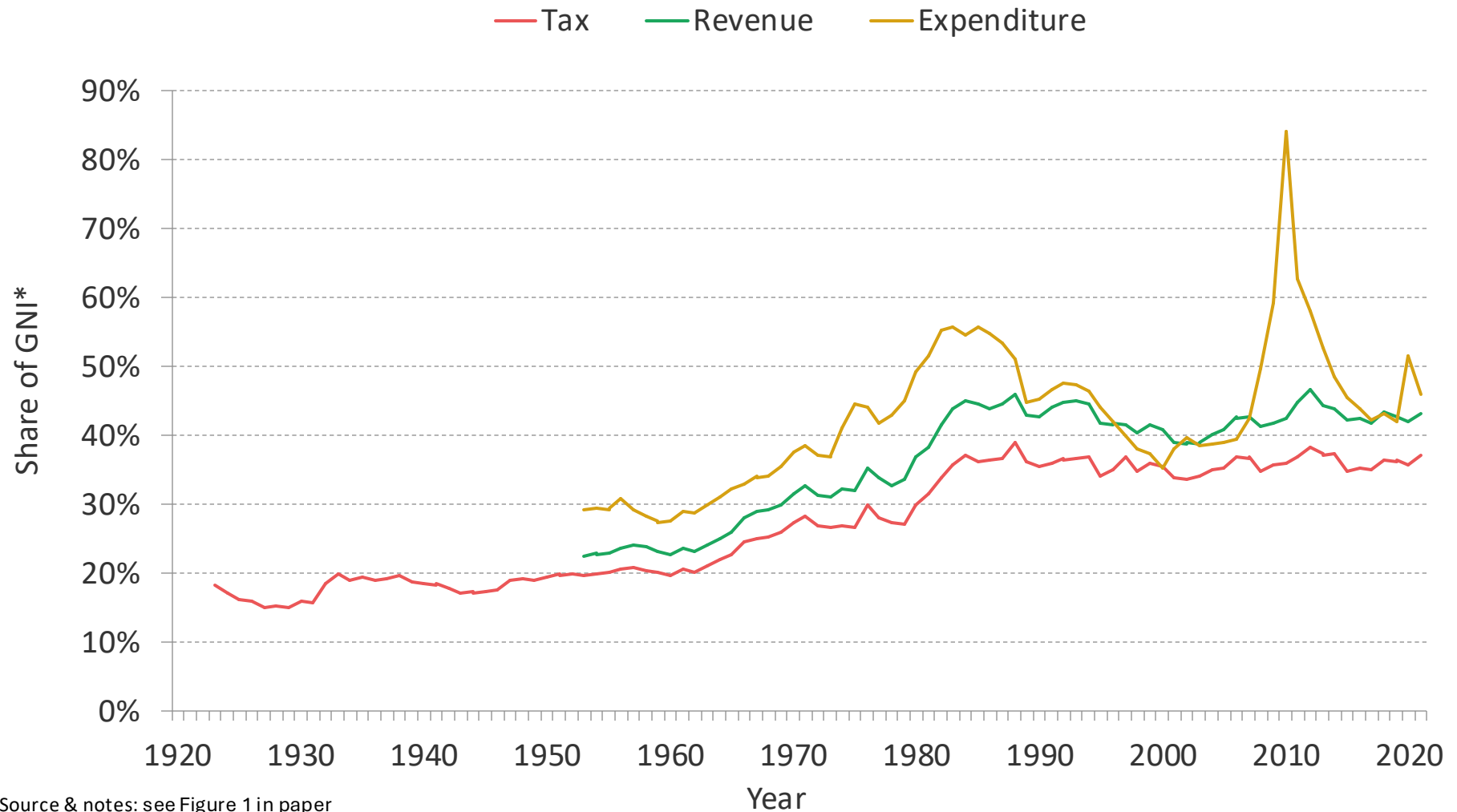
Look first at the changing size & shape of the Irish fiscal state

Then consider direct (or mechanical) role fiscal policy plays in shaping distribution of resources through the tax & transfer system

Conclude by looking at what we know about how taxes & transfers affect economic behaviour in Ireland (far less than we should or could)

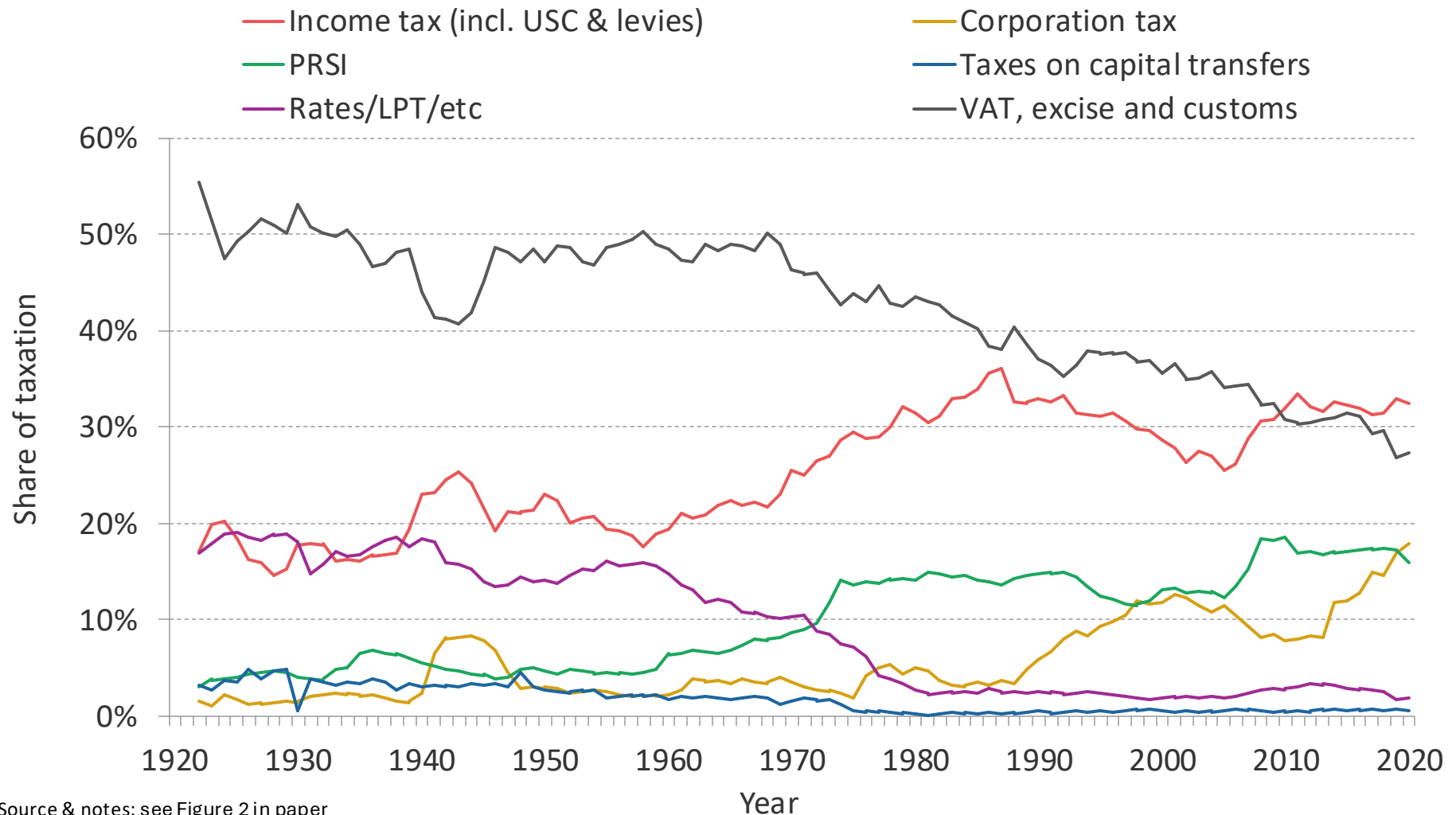
The changing shape of the Irish fiscal state

As elsewhere, the size of Government has grown substantially as a share of national income



The changing shape of the Irish fiscal state

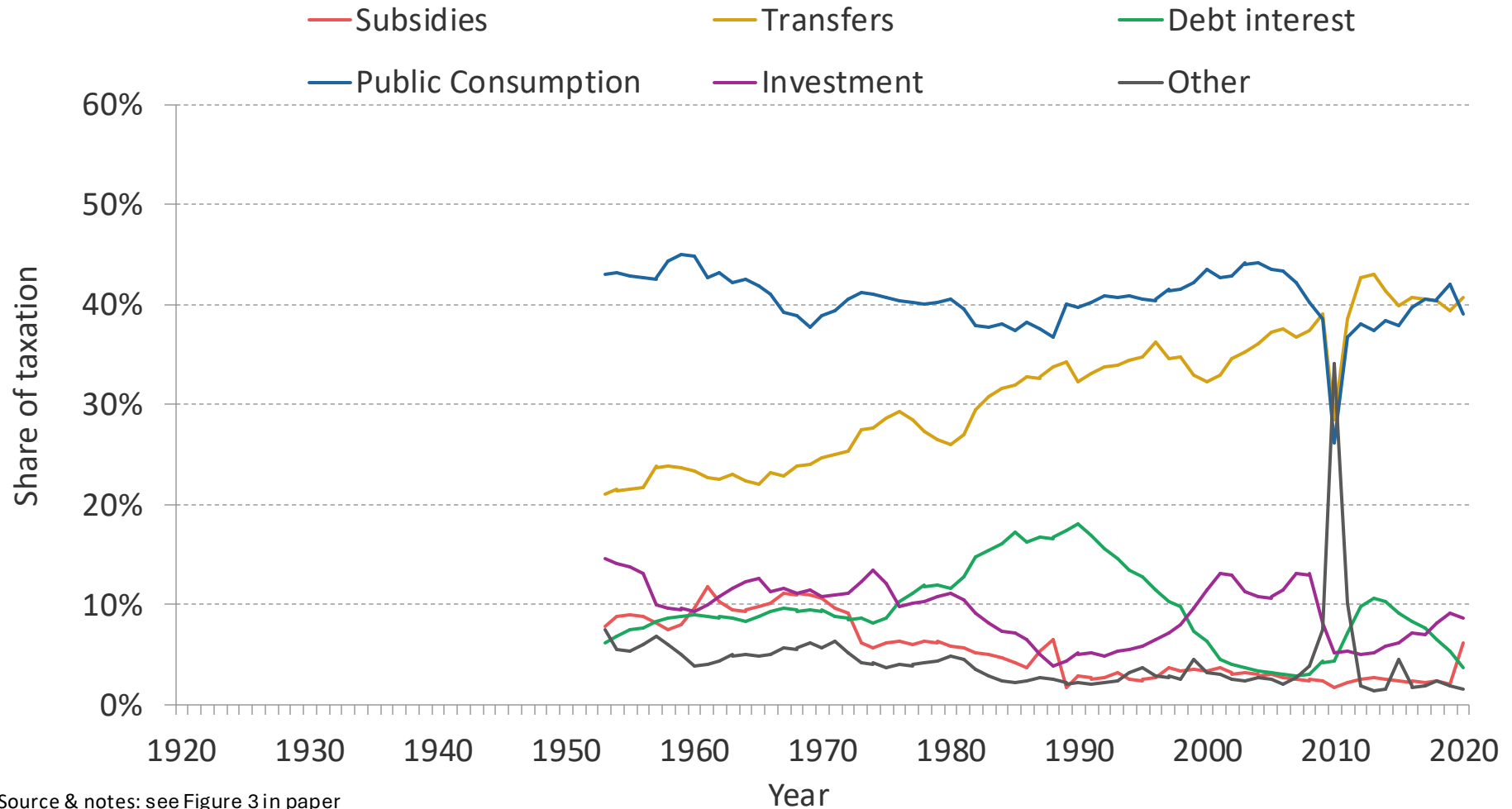
There has also been a shift in taxes away from consumption & property but towards income



Source & notes: see Figure 2 in paper

The changing shape of the Irish fiscal state

... while spending has shifted towards transfers at the expense of subsidies, investment & debt interest



Source & notes: see Figure 3 in paper

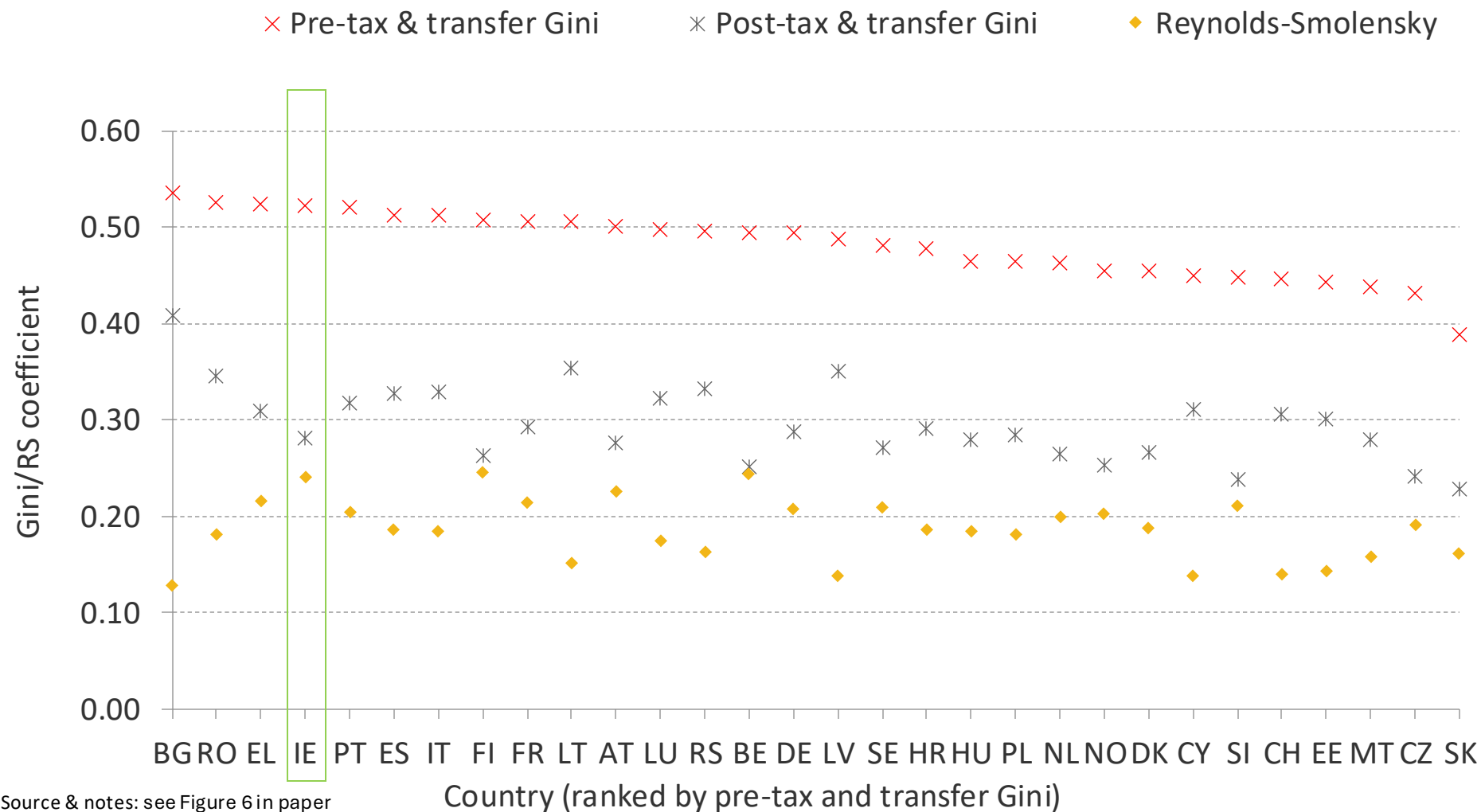
Direct effects of fiscal policy on redistribution

This increase in the importance of income taxes & transfers has consequences for redistribution



Direct effects of fiscal policy on redistribution

... with common measures of redistribution showing taxes & transfers do more to reduce income inequality in Ireland than in most other EU countries



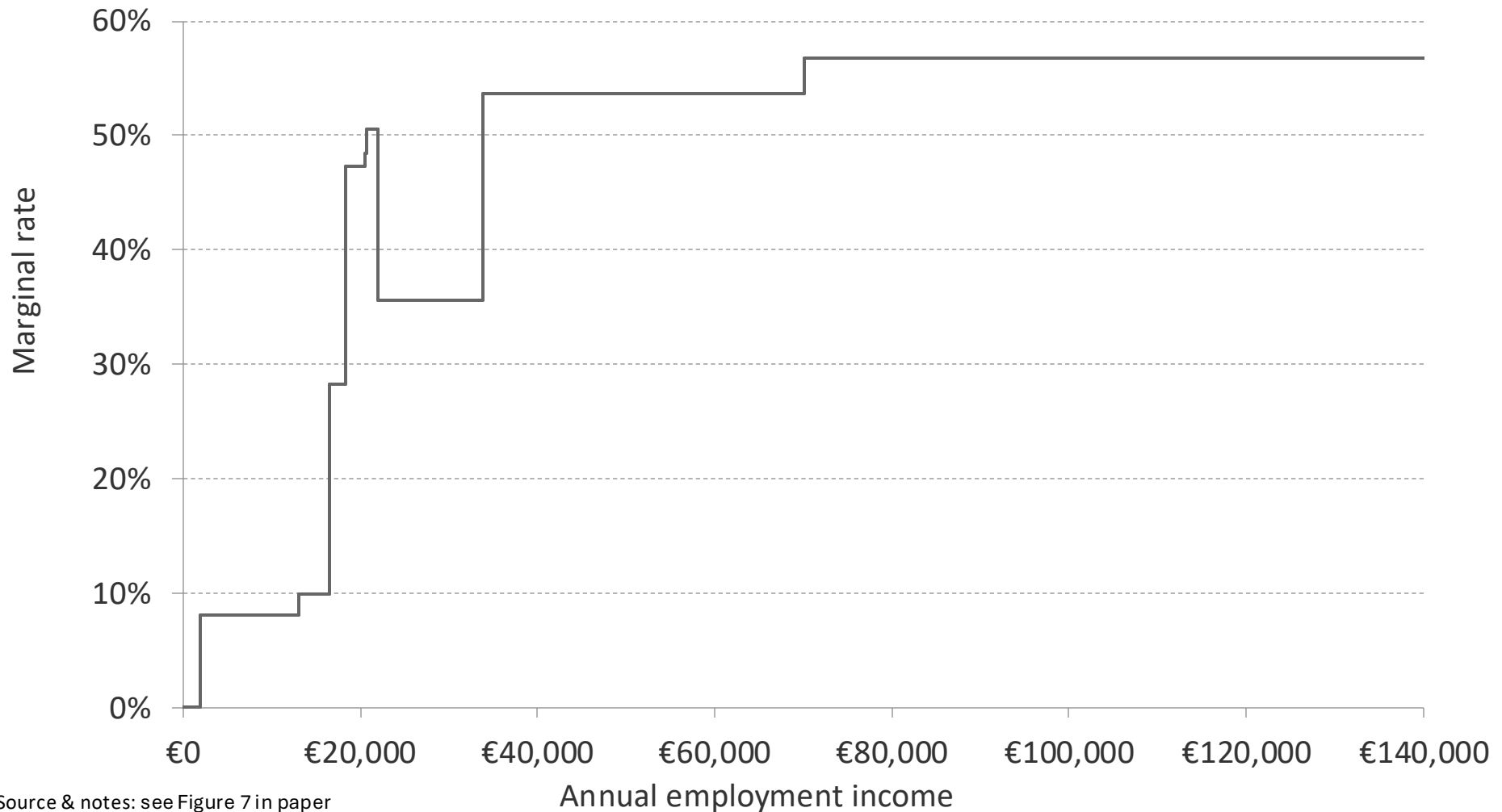
Direct effects of fiscal policy on redistribution

However, such measures of redistribution come with (many) caveats

- 1. Do not account for indirect taxes, which are less progressive than most direct taxes (so overstate degree of redistribution)**
- 2. Do not account for wider public spending e.g. on health/education**
 - ... though distributional impacts of this can be tricky to estimate
- 3. Computed only at a particular point in time**
 - Given individuals' circumstances vary substantially across the lifecycle & over time, likely overstate the degree of redistribution
- 4. Take as given the distribution of pre-tax and transfer income**
 - Do not account for any effect taxes & transfers have on the decisions of individuals, households and firms which can shape the distribution of pre-tax and transfer income we observe
 - What do we know about these effects here in Ireland?

Indirect effects of fiscal policy on redistribution

While taxes on labour income can impose high marginal rates at even low levels of income



Indirect effects of fiscal policy on redistribution

... extent to which this affects taxpayers' choices depends crucially on the responsiveness of taxpayers

Limited research using modern empirical methods & microdata in IE

- Exceptions include Hargaden and Roantree (2019), Acheson et al. (2018) and Doorley (2017), who all find relatively modest responses to taxes
- Contrasts somewhat with earlier empirical work using microdata which found higher (but falling) responsiveness for women

More difficult to reconcile with macro data/model estimates which suggest labour supply is highly responsive to taxes/net wages

- Issue not unique to Ireland, but little discussed here

Means hard to say what effects the (in places) sharp disincentives created by our personal tax system have on the distribution of earnings

Indirect effects of fiscal policy on redistribution

Similarly, we have little empirical evidence about how taxpayers in Ireland respond to the very strong incentives created by our system of taxes on capital income and transfers

As well as being charged at a lower rate than on most labour income (33%), exist multitude of CGT reliefs/reduced rates with poor economic rationale

- Exemption of Principle Private Residences entirely from CGT
- Full relief on assets that are transferred at death ('step-up basis')
- Extensive relief on the disposal of certain business or farming assets (Retirement Relief for those aged 55-70; 10% Entrepreneur Relief)

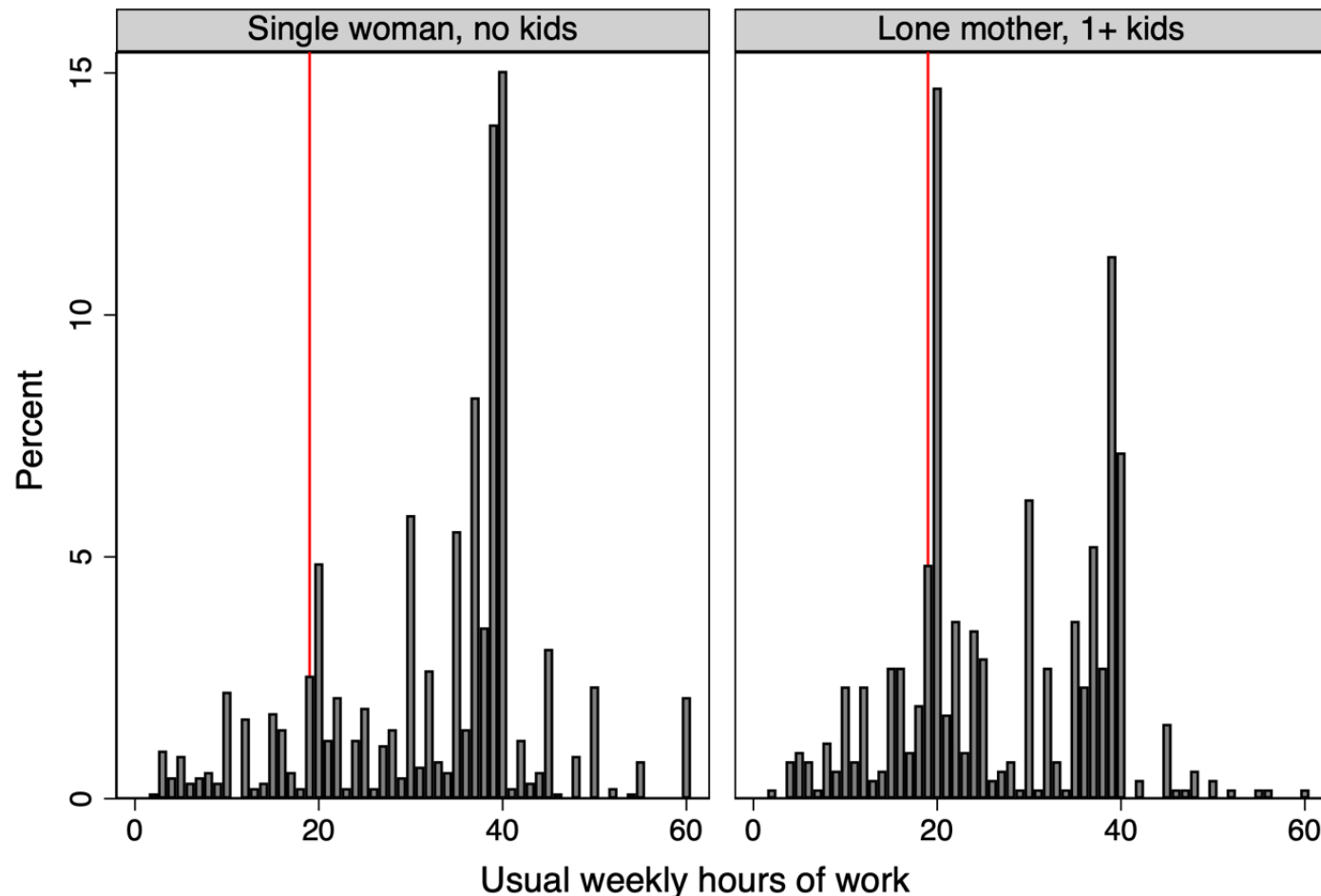
Uncapped CAT Business & Agricultural Relief create extremely strong incentives to hold wealth intended for a bequest in particular forms

- 90% write down in value of assets amounts to CAT free allowance of €3.35m with effective rate of 3.3% above for kids of wealthy parents

While incentives strong, no good empirical evidence on responses

Indirect effects of fiscal policy on redistribution

And while much work documenting financial work incentives created by means-tested transfers, little estimating the effects of these incentives on behaviour (although some suggestive patterns in data)



Source: 2015-2019 EU Survey of Income and Living Conditions (SILC)

In short, we know less than we should or could

Means we know very little about the welfare costs of taxation given how centrally these depend on the responsiveness of economic behaviour to taxes and transfers.

Limited research on the welfare costs of taxation in Ireland isn't new

- Neglect of “the deadweight losses associated with different forms of taxation in Ireland” lamented by Honohan and Irvine (1987)

But while there has been huge growth in empirical research looking at these questions elsewhere, much more limited here: why?

- Primarily data access & incentives: easier for Irish based researchers to use & get published using e.g. Danish administrative data

Net result is there isn't enough research on effects of fiscal policy in IE

- Honohan (1995) highlighted role of the Foundation for Fiscal Studies in encouraging “a diversity of researchers ... to turn their minds to matters fiscal”: time for a renewed or similar initiative?



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Thank You