ISME Pre-Budget Submission 2022

Managing Recovery

Presented to

Minister for Finance

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And

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Irish SME Association

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ISME
Irish SME Association

INTRODUCTION

ISME, the Irish Small & Medium Enterprises Association, represents more than 10,500 SME businesses throughout the Republic, employing more than 245,000. We are an INDEPENDENT body representing owner managers of small & medium businesses in Ireland. We are independent because we rely solely on the resources of our members, not on banks, semi-states, or big business. We are the only independent representative body for SMEs in Ireland.

While normally a fiscally conservative organisation, ISME recognises the need for the State to act counter-cyclically as we manage our way out of the Covid-19 pandemic. As we stated in last year's pre-budget submission, now is the time to spend, particularly on long-term capital-intensive projects, as value for money will not be there when asset prices start to rise again.

We have grave reservations about spending commitments the State is entering into on the current side. In the short term, running a negative primary balance is not merely warranted, it is essential. However, this should only be tolerated until the economy lifts sufficiently to generate a primary balance. Continuous deficit spending is simply not an option for a state with one of the highest per capita government debts in the word. The data produced by IFAC in its Long-term Sustainability Report[1] suggest that after 2025, the unfunded spending commitments being currently entered into by Government will produce increasing negative primary balances for the twenty-five years after that. This is unacceptable and unsustainable.

We welcome the Mission Concluding Statement from the IMF[2] on 12th May, and echo their recognition of ISME concerns such as the debt-GNI* ratio; the need for enhancing social capital in education, training, health, housing, digital and other physical infrastructure; and the need to get more women into the workforce. We are delighted they advocate a multi-pronged approach to the provision of social housing; the housing shortage is a massive issue which cannot be "outsourced" to SME employers through forced wage increases.

Domestically, our concerns are:

- *We have no plan to control current-account spending after we emerge from the current pandemic.*
- *There appears to be a broad consensus (to which ISME does not subscribe) that a bigger state, with a bigger price-tag, is required; while at the same time there is neither a consensus nor even a debate as to how this should be funded.*
- *The health vote was out of control pre-Covid-19. Ireland's health care expenditure as a share of national income ranks 1st in the EU15[3] but in 9th place when adjusted for relative prices and 2nd highest cost per head of population. Yet the Sláintecare program suggests no strategy to achieve value for money or efficiency in our health spend.*
- *Covid-19 has exposed serious gaps in our plans for E-Health. Our patient records systems were unable to efficiently manage a national vaccine rollout. A functional E-Health system must precede Sláintecare.*
- *The Irish tax-base remains dangerously narrow at a time when the United States is proposing fundamental changes to the corporation tax regime.*
- *Our political system appears structurally incapable of confronting vested interests engaging in rent-seeking behaviour or refusal to reform and modernise.*

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[1] Long Term Sustainability Report IFAC July 2020
[2] Ireland: Staff Concluding Statement of the 2021 Article IV Mission
[3] How Does Irish Healthcare Expenditure Compare Internationally? ESRI October 2020

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EXECUTIVE SUMMARY

Our budget priorities assume that Ireland will have exited the pandemic-induced recession in 2022 but will suffer tail effects.

1. Extend ***fiscal life-support*** to SMEs through targeted, grant-based liquidity supports.
2. Implement a series of ***basic tax reforms***.
3. Make permanent the temporary reduction in the ***punitive 23% VAT*** rate to 21%.
4. Our taxes on property, ***commercial rates and LPT***, need to be reformed.
5. While ***spending on infrastructure*** is now at the levels we have previously sought, we are concerned about value for money, particularly on the National Broadband Plan.
6. Our ***inheritance Tax*** regime must be reformed to incentivise the scaling up rather than sale of family businesses.
7. Government continues to ignore the reports by the ***Irish Fiscal Advisory Council (IFAC).*** In view of where the global economic cycle is at present, this is a matter of concern.
8. Our ***further education and training*** regime is inconsistent with activating a bigger workforce, or training the unskilled. We also acknowledge that our domestic SME base requires extensive training to improve its productivity. This should be incentivised via the tax system like the Teagasc 'Green Cert.'

COVID-19 and Aftermath

Even as early as Q1 2021, SMEs were showing signs of optimism[4] for the year ahead. However, it is also clear that many business sectors in Ireland will not be even close to 2019 levels of trade until well into 2022, and that there will be legacy debt and trading issues which will threaten the commercial viability and solvency of many SMEs.

Having lobbied so hard as part of the Local Jobs Alliance and SME Recovery Ireland, on behalf of SMEs hit badly by the pandemic, we were very disappointed to see key elements essential for small business recovery being neglected by Government. The Central Bank suggests[5] up to a quarter of SMEs are in severe difficulty. Issues which still require action[6] are:

- A non-usage penalty for any unused funds should be applied to any distribution partner for SME liquidity.
- Incentivise small businesses to pay creditors within 90 days by providing a 3% VAT rebate for invoices paid on time.
- Introduce incentives to encourage equity investment in small companies.
- Rebuild SME balance sheets: While the Restart Grants, CRSS and SBASC were all well-received upon introduction, there is a piecemeal, lethargic approach to SME support which suggests an absence of comprehension of how serious the situation is.
- Speedily introduce a less onerous examinership and liquidation process. (This is promised, but must include the repudiation of onerous leases and must not exclude the Revenue if it is to be successful)

Policy Responses to Covid-19

The unique economic characteristics of the recession caused by the Covid-19 pandemic required appropriate policy responses. This recession was not caused by any form of commercial irresponsibility, it is caused by a necessary

[4] ISME Trends Report Q1 2021
[5] https://www.centralbank.ie/docs/default-source/publications/research-technical-papers/new-survey-evidence-on-covid-19-and-irish-smes.pdf
[6] SME Recovery Ireland Final Report

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Government-mandated shutdown of economic and social activity. We should not waste this opportunity to look afresh at our fiscal system.

TAXATION

Tax Reform

We have gone through one full economic cycle without any meaningful reform of the tax code. The Government has indicated that there will be a Commission on Taxation and Social Welfare in the life of the current Dáil, which we believe is long overdue. We make the following 18 recommendations.

1. Our **CGT rate at 33%** is fourth highest in the OECD, and negatively impacts investment and scaling in Irish businesses. A reduction in CGT would almost certainly increase the yield. Those who support the current CGT rate should be asked to justify whether they support a lower than possible tax yield.
2. **Introduce a Solidarity Tax of 3%** on income over €100,000 (see below).
3. **Reform VAT** (see below).
4. **Reform Property Taxes** (see below).
5. **Entrepreneur relief is too tightly restricted to owner-managers** and discourages external and serial passive investors from the possibility of a lower CGT rate. This restriction should be removed, and the €1m lifetime threshold for entrepreneur relief also needs to be increased to a minimum of €10m. While Government policy purports to encourage equity investment in SMEs, the subsequent treatment of those very investors is punitive.
6. The progressivity of our **marginal tax rates**** above the average industrial wage discourage personal advancement, upskilling and promotion.
7. The **KEEP scheme** remains too complicated and restrictive for use by SMEs. The changes announced in budget 2019 have not addressed this, and the 'lifetime limit' element introduced has made the scheme less attractive.
8. The administrative blockers for businesses in claiming the **R&D tax credit** must be removed. As with the KEEP scheme, the structuring of the R&D tax credit discourages or prevents SMEs from applying for it.
9. **Reform Capital Acquisitions Tax** (see below).
10. The **Knowledge Development Box (KDB)** remains in need of reform for SMEs.
11. Ireland has a limited number of individuals who have funds to invest in business through the **Employment and Investment Incentive (EII)**. SMEs are too reliant on the pillar banks, and need a more diverse range of finance options.
12. **The EII income tax relief for investors is also split into two tranches –** 30% in the year of investment and an additional 10% after three years. This split relief concept reduces the attractiveness of the EII and should be removed.
13. **EII rules require the investor to hold less than 30% of the company's shares**, denying relief to the founder shareholder. This restriction should be removed from our regime.
14. Limitations on **outsourcing in the R&D tax credit regime** restrict collaboration among Irish businesses and between businesses and third-level institutions. These restrictions do not exist under the OECD Modified Nexus rules and should be removed.
15. **The definition of "basic research" is so onerous in qualification for the R&D tax credit**[7] that it discourages SMEs from applying for it unless they can show their research is new to the world. The definition is: "experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge without a specific practical application in view." SMEs should qualify for this credit if they undertake research new to them.
16. The **Start-Up Refunds for Entrepreneurs (SURE)** scheme should be extended to include new business founders who were previously self-employed and are starting up another business. (A proviso could be that the self- employed person cannot have previously left a Revenue debt unpaid.)

[7] https://www.revenue.ie/en/tax-professionals/tdm/income-tax-capital-gains-tax-corporation-tax/part-29/29-02-03.pdf

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17. **Dividend income is taxed at high marginal personal tax rates of up to 55%**, which does not encourage equity investment in Irish business. Introduce a lower flat rate of taxation on dividend income.
18. Consider **a new talent regime similar to SARP** but targeted at SMEs.

** While ISME understands the fiscal and political difficulties with raising the marginal rate thresholds, Irish workers are taxed at marginal rates at far too low a level of income, even by comparison with Scandinavian exemplars. The average industrial wage stood at €42,997 in Q4 2020. The marginal rate entry point for a single worker is €35,300, which is 18% below the current average industrial wage. Future taxation policy should set benchmarks against the average industrial wage, with a view to getting to 150% (i.e. €64,496). This would still be a low marginal rate threshold by international comparison. By contrast, French workers pay 41% tax only on earnings above €73,517, and pay a 45% rate on earnings over €158,223.

Solidarity Tax

ISME has long lobbied for an end to discriminatory tax measures levied against the self-employed. Equalising the earned income credit for the self-employed with PAYE workers was delivered years after it was promised. However, for high-earning self-employed workers, the 3% USC surcharge remains in place. It is now apparent that this discriminatory levy will not be ended. We therefore consider that a USC surcharge of 3% should be introduced for all PAYE workers earning over €100,000 per annum, or a third PAYE rate of 43% should be introduced for the same cohort. Revenue estimates suggest this would yield in excess of €300m per annum for the Exchequer.

VAT

When the 9% VAT rate was originally introduced, it was accompanied by an increase in the standard rate from 21% to 23%. The 9% rate has been removed, despite its having attracted over 30,000 jobs into the hospitality sector. Yet the 23% rate has remained in place and is one of the highest rates in Europe. The temporary reduction of the punitive 23% rate to 21% should be made permanent at its original level. If it has the impact of stimulating consumer spending, the net impact on public finances will not be significant as the VAT take will increase overall if spending is increased.

Property Taxes

Reform of property taxes is long overdue. Commercial Rates and Local Property Taxes are technically linked, in that they are both based on what are effectively 'retail' valuations for property. The legislative basis for our rates system dates from 1898 and is unfit for purpose. Our members are willing to consider updated rates calculations systems. The current rates system requires substantial overhaul before it threatens business viability. It discriminates against town-centre operators, and encourages urban sprawl and donut development, contrary to Project Ireland 2040.

Similarly, LPT is based on an open-market valuation basis, which penalises urban-dwellers, and those who invest in and upgrade their homes. LPT discourages densification and urbanisation, both key objectives in the National Planning Framework for Project Ireland 2040. Furthermore, the exemption of post-2013 builds is a fundamental and inexcusable inequity in the taxation system which must be plugged immediately if it is not to face legal challenge.

Provisional figures from the Department of Housing, Local Government and Heritage show that €480 million was collected by the LPT last year.[8] Funds generated by the LPT are transferred to the centralised Local Government Fund which is used to support the provision of local public services. In comparison to last year's figure, €258 million was collected in 2013.[9] A compliance rate of 94.4% was registered despite the difficulties created by Covid-19 last year. The LPT's predecessor - the Household Charge - which was collected directly by local authorities rather than the Revenue received a far lower compliance rate than the LPT, with some years now seeing 97% or 98% compliance rates.

[8] https://www.revenue.ie/en/corporate/documents/statistics/lpt/local-property-tax-2020.pdf
[9] https://www.revenue.ie/en/corporate/documents/statistics/lpt/lpt-stats-2013-2015.pdf

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The amount of tax paid is calculated proportionate to the value of the property in question and the LPT involves self-assessment of property values. The Revenue offers a guide on how to value a property but will not itself provide property values. Properties worth more than €1 million are placed in the top rate and pay 0.18% in LPT on the first €1 million and 0.25% on the portion above €1 million.

In order to address the systemic failures in the LPT system as currently structured, ISME proposes the following five key reforms:

- Firstly, a site value tax should replace the open-market valuation basis applied to property for LPT purposes. A site value tax, unlike the current LPT, would involve taxing proportionate to the value of a site, rather than the value of what is built on a site. Rather than taxing the entirety of a property, that being the land and what is built upon the land, only the value of the land is taken into account. This places greater emphasis on factors such as the location of the land rather than factors within the control of the individual that allow for the generation of positive economic activity such as construction of buildings on land or the improvement and development of existing buildings, which the LPT serves to discourage. This is also consistent with the strategic objectives of Project Ireland 2040

- Secondly, a charge should apply on zoned land. This is a use or lose it charge that will force land holders to either develop land, pay the tax and retain the designation or derate land they do not intend to develop. This will generate income but also provide councils with a better understanding of the land that will be developed. The purpose of this is to encourage land development and discourage the hoarding of zoned land.

- Thirdly, a levy on road frontage (or a load factor on an LPT valuation) can perform a critical function in the future funding of local government. In a fair and equitable system, road frontage should form a more important indicator of how much tax should be paid by property owners; and encourage the efficient use of land in areas already serviced by state infrastructure. A road frontage levy would discourage ribbon development and encourage rural densification.

- Fourthly, and pending the introduction of the reforms above, those properties built since 2013 and all new homes should have a provisional valuation applied to them for LPT this year. In view of the average house prices nationally[10] in Q1 2021, we suggest provisional valuations as follows:
    - Dublin: €325,000
    - Cork, Galway: €275,000
    - Limerick, Waterford: €225,000
    - Rest of Ireland: €175,000

- Finally, Government should commit to completion of a national review of individual LPT valuations by end of 2022. Thereafter, LPT revaluations should recur every five years, perhaps in Census year.

While the commercial rates system differs in the detail of calculation from LPT, it is also based on an open-market "retail" property valuation, and this suffers the same systemic failures as LPT. As currently structured, commercial rates penalise town-centre development and encourage donut development. For this reason, we believe the basis of valuation for commercial rates should also be site value.

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[10] https://www.thejournal.ie/daft-report-3-5395912-Mar2021/

Capital Acquisitions Tax (CAT)

CAT was introduced in 1975 as an inheritance/gift tax with a threshold of the equivalent of €190,461. If indexed at the CPI rate, this would now equate to over €1.3m, instead of the current €335,000 ('Group A'). The effect of this is to diminish the attractiveness of intergenerational transfer of business and is one of the reasons so few Irish family businesses reach the scale of their continental cohorts.

There is a 90% CAT relief in the transfer of business assets from one generation to another. But this only applies where control of the business transfers at the same time. This is neither possible nor desirable in all cases. In many cases the first generation retains title in property, in order to maintain a post-retirement pension. If family-owned Irish business are going to 'scale not sale' then CAT must be reformed.

SPENDING

Infrastructure

Ireland has a shortage of affordable housing, and critical underinvestment in its potable and wastewater infrastructure. It has under-developed high-capacity urban transport networks. It remains dependent on fossil fuels for energy generation.

The average house price in Ireland in Q1 2021 was €275,751.[11] This is a multiple of 6.3 times the average industrial wage of €43,939, and 13.5 times the annual National Minimum Wage of €20,483 (2020). While the latest Daft Rental Report[12] shows rents falling in Dublin, the pandemic has, perversely increased rents outside the capital, leading to an overall 1.7% increase in rents. It is simply not in the gift of most SME employers to increase wages in line with these increases, and the State will have to intervene to provide adequate social housing at affordable prices.

In our previous pre-budget statements, we argued for a slow-down in capital spend into the next recession. That time has come. We should spend heavily on the capital side in the next few years, while containing our current spend.

Encouraging the Green Economy

Ireland's climate action targets[13] are ambitious, especially in light of forecasted increases in electricity demand over the coming decades. Reducing carbon emissions will prove extremely difficult if, for example, data centres will consume up to 29% of our electricity output[14] by the end of this decade. Before addressing our future energy requirements, we should consider if all of that future power demand is necessary or appropriate: i.e. should Ireland invest in substantial energy generating capacity simply to permit the long term storage of cat videos and TikToks? Would it not be more appropriate, as the European headquarters for so many digital media companies, to encourage the adoption of data retention policies which discourage the amassing of digital media?

The SME sector can play an active role in assisting the State if it is appropriately encouraged to do so. Those technologies which can markedly reduce energy consumption, such as LED lighting, should be incentivised with measures such as reducing or removing the recycling charge, and preferential VAT rates. The Government should be willing to consider use of the VAT system to further stimulate the sale of low-consumption technologies. Similarly, the current methodology for calculating the PSO levy (which is under review by DCCAE as part of the Integrated Single Electricity Market (I-SEM) project) runs counter to Government policy on encouraging uptake of low-carbon technologies. Until this review is completed, the PSO levy must be frozen. Government must ensure it does not disincentivise any carbon mitigation strategies through taxation or levies.

[11] Daft.ie House Price Report Q1 2021
[12] https://ww1.daft.ie/report/2021-Q1-rental-daftreport.pdf?d_rd=1
[13] Climate Action Plan 2019
[14] https://www.irishtimes.com/business/energy-and-resources/eirgrid-chief-backs-case-for-review-of-data-centre-policy-in-ireland-1.4558482

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Ireland has invested very heavily in wind energy. However, wind continues to suffer from the problems of intermittency and storage. Solutions proposed to the latter problem include batteries, liquid air, thermal storage and kinetic energy.[15] However, Ireland's position as an Atlantic island with a mature gas network offers us a chance to fully exploit our investment in wind, while taking the lead in floating offshore wind (FLOW).

Rapid developments in FLOW technology allow deployment in waters from circa 60m to 1000m depth. FLOW can produce high wind capacity factors, as well as making practicable the production of hydrogen from the electrolysis of seawater. This green hydrogen can be injected, for example, into our domestic gas network or burned directly in gas-fired electricity generation. It can also be produced from FLOW at scale for export. There is no reason why, with suitable supports, Ireland's FLOW system and attendant support technologies cannot become world-leading.

Lastly, if we are serious about an economy based around ever-denser electrification, we must be mature enough to commence a discussion on the use of new nuclear energy generation systems, such as small modular reactors, advanced fission, and thorium-based nuclear power.

National Training Fund and the "Blue Cert"

The National Training Fund continues in substantial surplus while we have a number of known shortfalls in education, as well as a substantial degree of 'over-education.'[16] The NFT needs to be targeted at addressing the emerging issues:

- As Ireland reaches peak employment, many sectors across Ireland are facing a national skills crisis, which is affecting the competitiveness of enterprises. The lack of skilled employees is causing poaching of staff, unrealistic and unsustainable strains on employers to compete to maintain their employees. This skills shortage is affecting the competitiveness of enterprises.
- Apprenticeships offer both the employer and apprentice an excellent way of training however the two-tiered apprenticeship schemes offered by government will continue to cause hardship for employment sectors where the median wage is low. The post 2016 apprenticeships require the employer to pay the apprentice while both on and off the job. This system must be reviewed to encourage employers to take on and train apprentices in a sustainable way. A supporting scheme should be made available to support post 2016 apprenticeship (like Job bridge or Jobs plus) or to reintroduce the pre-2016 model where the government covers the cost of training while the apprentice is off the job as in electrical, plumbing and motor apprenticeships etc.
- Training rate: The removal of the training rate has affected some employers' ability to train staff and many sectors are no longer taking on trainees. While the protection of low paid workers is a priority, this must be balanced with the demands and cost of training apprentices. Additional support should be made available to encourage employers to engage with available apprenticeships.
- Life-long learning as a key component in workforce development. Additional financial support should be directed from the NTF towards supporting those in employment, to upskill them in a manner that is enterprise-led.

We need to align pre-employment education to the needs of the industry. Additionally, a review of career guidance should take place to support school leavers choose a path that is most appropriate, and to emphasise the benefits of apprenticeships for students with the apt skills.

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[15] https://world-nuclear.org/information-library/current-and-future-generation/electricity-and-energy-storage.aspx

[16] https://www.irishtimes.com/news/education/irish-workers-are-most-overqualified-in-europe-1.3229608

ISME acknowledges that the productivity issue among Irish SMEs is real. Productivity is static or falling in the domestic economy, as is profitability. In his Seanad Public Consultation Committee Report on Small and Medium Sized Businesses in Ireland,[17] Senator Padraig O'Céidigh identifies productivity as a key element in value creation by SMEs.

This is occurring at a time when there is an increasing trend toward protectionism globally; when our nearest and largest trading partner is leaving the single market, and when US, OECD and EU Commission trade and corporation tax policies threaten the long-term viability of our traditional industrial policies based around foreign multi-national corporations.

If we are to scale our indigenous enterprise base, it is imperative that we address latent deficits in managerial skills within our SMEs; particularly financial management, IT capability, marketing capability, innovation, personnel development, risk identification and management, research capability, and strategic planning.

The "Blue Cert" is a proposed programme of training and development for SME managers and owner managers. It is specifically designed to give SME managers a broad range of necessary knowledge and skills to perform their business activities and manage their businesses in a safe, ethical and professional manner.

The Blue Cert provides trainees with a solid grounding in finance, human resource management, IT and marketing. Participants learn how to manage core responsibilities of company compliance – financial transactions, employment, environment and health and safety record keeping.

The programme has been designed jointly by ISME, Network Ireland and Griffith College and has been directly informed by industry regulators such as HSA and WRC, with plans to also seek input from Revenue Commissioners and to ensure its compliance with developing environmental and sustainability opportunities and requirements.

The programme is being designed at level 6 on the National Framework of Qualifications and will lead to a special purpose certificate award. The programme is delivered using a combination of online and in-person delivery to facilitate participants' employment commitments and schedules. It is expected that participants would attend the programme over three ten-week periods within a calendar year, with up to 6 hours being delivered each week using a combination of online delivery (lunch-times / evenings) and occasional in-person workshops.

The programme would be spread over a calendar year to facilitate participants' assimilation and practice of the skills involved and their companies' work schedules. The learning and development for participants is expected to equate with 60 ECTS (the equivalent of a year in further / higher education).

ISME estimates the cost per trainee is expected to be €5,950 for the overall programme, and we ask for tax support equivalent to the Teagasc Green Cert to be provided for in Budget 2022. Since this qualification will not be limited to the second generation in family businesses, there will be a requirement for a tax benefit beyond the CAT reduction currently applicable under the Green Cert. We suggest this could be by way of additional tax credits. However, given the fact that the NTF will have accumulated more than half a billion euro by the end of 2021, we see the expenditures under this program netting off only a small fraction of the funds available under the NTF.

The principle that educational attainment merits extra pay is established elsewhere. For example, teachers qualify for an annual allowance[18] of between €532 and €5,526 based on QQI level attained. We would not seek anything as advantageous as that, but we see the merit for employers, employees and the Exchequer in providing a once-off financial and/or tax incentive.

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[17] https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/seanad_public_consultation_committee/reports/2019/2019-05-16_small-and-medium-sized-businesses-in-ireland_en.pdf

[18] https://www.tui.ie/_fileupload/TUI%20Salary%20Scales.pdf

OTHER

Review of Indigenous Industrial Policy

There is now a consensus among trade and economics professionals that Ireland's economic policy remains too heavily invested in the multi-national corporation sector. While ISME is first to acknowledge the contribution from this sector to corporation and payroll tax receipts, and to high levels of disposable income, the sector remains very exposed to externalities such as US trade and tax policy. As far back as 1982, the Telesis Report argued that Irish industrial policy was excessively focussed on mobile investment from abroad, at the expense of indigenous industry. Similarly, the Culliton Report of 1992 argued for the creation of an agency solely devoted to Irish industry. While we now have Enterprise Ireland, we lack a national vision of what policy prescriptions indigenous enterprise should follow in order to allow them to scale, and to decrease our dependence on the MNC sector.

ISME has argued every year since 2003 for a fundamental review of indigenous industrial policy. Our call for a policy review is not a binary SME 'or' MNC. We see a mutually beneficial symbiosis between the two in a 21st Century policy review. We believe the case has never been stronger to initiate one now.

Statutory Redundancy Rebate

As of February 2021, Ireland had a COVID-19 adjusted unemployment rate[19] of 24.8%. This is almost 10% higher than our worst unemployment rate during the Great Recession. While state supports have maintained many jobs on a form of life-support, the outworking of the pandemic will mean that many of their employers will cease to exist within the next year.

ISME has lobbied for several years for the restoration of the statutory redundancy rebate. While this issue attracted no attention as we approached full employment, the jobs market is being ravaged by Covid-19. One of the unintended effects of making redundancy more expensive or difficult for employers is that they are less likely to hire employees, and more likely to use agency or contracted labour. The cost of meeting statutory redundancy liabilities may also render some businesses insolvent.

The Government reduced the rebate on Statutory Redundancy in 2012 and eliminated it in 2013. This was a mistake. Employers always had liability for a proportion of Statutory Redundancy payments, but the State provided an 'insurance policy' via the social fund to pay the balance. The employers' contribution to this fund was set at 0.5% (recovered via PRSI) in the Redundancy Payments Acts 1979. **This contribution was not terminated when the rebate ended.**

The employers' payments to the redundancy fund generated a substantial surplus over the fund's liabilities. In 2002, the then Department of Social Welfare paid a dividend of €635m to the Exchequer. The removal of a rebate (which employers were already paying for) was wrong, although done in the teeth of the recession. This justification no longer exists.

The Covid-19 moratorium on redundancies will soon end, and a tidal wave of redundancies is inevitable as businesses restructure through the pandemic. The more expensive the Government makes it to lay people off, the more reluctant businesses will be to re-hire once the pandemic is over. The statutory redundancy payment could make the difference between a solvent and an insolvent business. Therefore, the Statutory Redundancy rebate should be reinstated at its 2012 level (60%). Failing this, the requirement to pay statutory redundancy should be eliminated, or employers' PRSI should be reduced by 0.5% in lieu.

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[19] CSO Monthly Unemployment

Peer to Peer Lending

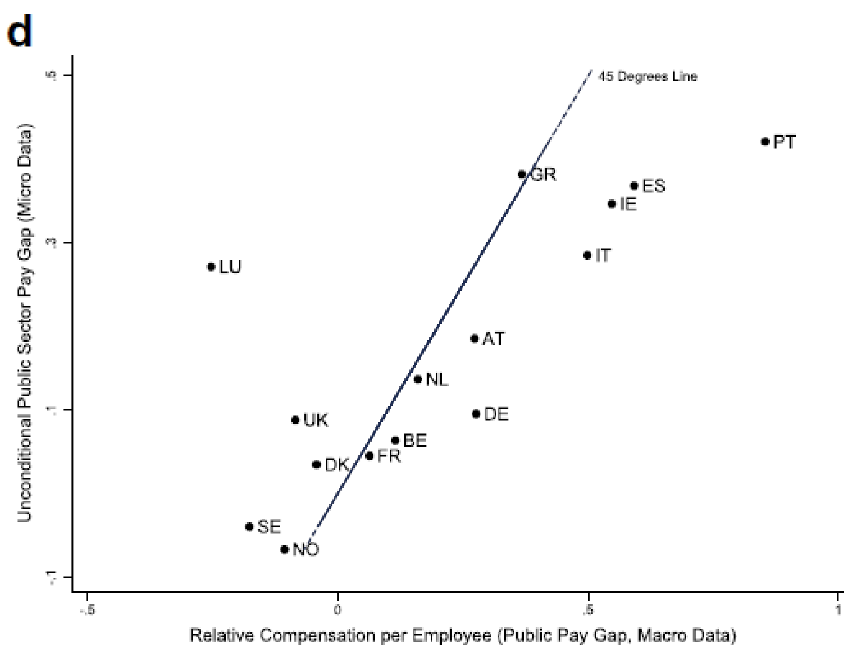
Covid-19 has cruelly exposed our over-dependence on our pillar banks. Despite huge effort by the SBCI to distribute urgently needed liquidity to our SME sector, that effort has run into the sands once credit applications get into our pillar banks. Ireland needs to broaden its banking base, and regulation of our peer-to-peer sector is a long overdue measure necessary in doing so.

Inexplicably, peer to peer lending remains unregulated, despite the influx of more providers. The longer this situation continues, the greater the risk we run of a major failure in the shadow lending area.

Public Sector Reform

The gap between public and private sector pay[20] (as of Q4 2020) stands at €236.20, or 30%. This is the lowest the gap has been for many years. In the UK, private sector pay nominally exceeds public sector pay by 0.5%. The published rates of pay for senior civil servants in the UK[21] suggest that most Irish civil servants of equivalent rank are already paid well in excess of their British counterparts. We know of no material level of age, qualifications, educational or vocational superiority of the Irish public service over their UK counterparts. Even at a low of 30%, this gap is only elsewhere seen in Mediterranean countries[22] (See figure 1 below) where private sector pay is far lower. This means that SMEs are competing against ***both*** foreign multinationals and the State for talent. That is a very difficult place to be for the majority of SMEs.

Figure 1: Understanding the public sector pay gap (Source: Campos et al)



The headline public-private pay gap ignores the much larger gulf between public sector pay and SME pay. As of Q4 2020, they stood at €1,024.53 and €667.53 respectively, a difference of 53%. The CSO continues to publish questionable justifications[23] for the existence of so large a gap, but critically, it does not explain how Ireland is such an outlier in comparative terms among its Northern EU peers. Actual comparisons between current rates of pay for

[20] CSO Preliminary Earnings Report Q4 2020
[21] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/949622/_150k_2020_Master_.xlsx
[22] https://izajolp.springeropen.com/articles/10.1186/s40173-017-0086-0
[23] https://www.cso.ie/en/releasesandpublications/rp/rp-eappp/eappp20152018/

our senior civil servants[24] (at an exchange rate of £0.87/€) and those in the UK[25] suggest that, with very few exceptions (which are mostly technical in role) Irish civil servants do significantly better on a like-for-like basis.

ISME has for several years called for Government to ***reduce the public-private sector pay gap to 10% by 2025.*** This looks unachievable, as the pandemic will likely increase the public-private sector gap.

ISME has stated publicly that while it did not object to an increase public sector pay in 2020, it should have been made in return for reform. Most of the clamour for pay increases come from those sectors with the poorest performance records. The OECD's 2020 Country Report[26] found a significant shortfall in outcomes for the public for the Health, Education and Justice sectors. To continue uncritically to raise public sector pay, without any call for reform or modernisation, at a time when there is no recruitment or retention crisis in the public service, and when the public finances are gravely challenged, suggests that the Department of Public Expenditure and Reform has lost both its grip and its *raison d'être*.

We consider the absence of a permanent pay-setting mechanism to be detrimental to good order in the public finances. The setting up of ad hoc commissions such as the Public Service Pay Commission in 2017 is no substitute for the maintenance of a standing pay commission such as the UK's Pay Review Body (PRB), which is run by the Office of Manpower Economics.[27] Despite the size of the UK's public service, the standing secretariat of the PRB is just 30 people. It is fed with specialist sectoral information in respect of doctors and dentists, NHS, police, prison service, schoolteachers, senior public service staff, and the armed forces.

Given the size and cost of the Irish public service, and the fact that the findings of the Public Service Pay Commission have been ignored by some of the trade unions, the establishment of an agency analogous to the UK PRB is warranted here. It would ensure that pay adjustments would be data-driven rather than extorted under the threat of industrial action.

The constant and ongoing threat of industrial unrest cannot be used as a justification for continued refusal to reform our public services. We can, through a continued focus on productivity and reform, deliver a world class public service affordable to our citizens and children. Properly digitising our public services in the public cloud can be part of the strategy to achieve that objective.

Pensions Reform

The introduction of the Covid-19 Temporary Wage Supplement Scheme exposed our employees' PRSI payment for what it really is, a marginal tax rate addition, not a genuine social insurance payment. This was also the finding of the last Commission on Taxation.

The PRSI system must cease to be used as a marginal form of taxation and must start to be used as social insurance. See also the "Jobs Kill Zone" below. As we are advising the DEASP:

1. ISME supports previous policy recommendations to move towards and auto-enrolment system for state pensions. State pensions must operate on a total-contributions basis, must provide for those who wish (or need) to retire earlier, and must allow those who contribute more (or who choose to work longer) to benefit more. Pensions must operate on a social insurance model, not on a taxation and fixed benefit model, Auto-enrolment should become the basis for all pensions paid in the state, including public service employees.

[24] https://assets.gov.ie/90209/c34ecf4b-c517-4e39-9e61-5955a7eb6385.pdf
[25] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/949622/_150k_2020_Master_.xlsx
[26] OECD Country Report Ireland 2020
[27] https://www.gov.uk/government/organisations/office-of-manpower-economics

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2. Jobseeker's Benefit is paid as a fixed weekly allowance to workers who have lost their jobs, irrespective of what their income level prior to unemployment. This is entirely inconsistent with the fact that the PRSI ceiling of €75,036 was eliminated in Budget 2011. Ireland must either re-introduce PRSI ceilings for employees or move to a social insurance model for payment of Jobseeker's Benefit.

3. The disability allowance system must preclude payment for 'lifestyle' disabilities, such as illiteracy. It is wholly improper for the state to pay someone to be illiterate.

While we acknowledge the pension benefits of an Automatic Enrolment (AE) for the employee, the proposed funding mechanism would have a negative employment impact, especially for lower paid workers. The employer contribution up to a maximum of 6% would represent a substantial increase in payroll cost for a great deal of employers, especially as the initially mooted state contribution of 25% has already been reduced to 20% in the latest iteration of the proposals. This would be a considerable burden, even if Coviud-19 associated costs were not present. While we acknowledge that the social contributions paid by Irish employers and employees by EU standards is low, so are the benefits to employees (which are fixed), and there is further the fact that pre-tax Irish payroll costs are high. This suggests that for a 6% employer contribution to not adversely affected employment levels, employees will have to absorb some or all of this (i.e. gross earnings cannot rise by the full amount of the increase).

The quantum of the State contribution to the previously proposed AE scheme is miniscule by comparison to its massive subsidisation of public service pensions and would be a maximum of €1,125 per worker per annum. Public service pension accrual attracts favourable tax treatment that is not accorded to private sector pensions savings. This would not encourage those who currently contribute to their personal pension to migrate to the AE scheme.

The unfunded pensions liabilities of the State are the largest threat to its long-term financial stability, and the DEASP remains the largest-spending Government department. It is therefore imperative that the DEASP receives robust, honest, independent and objective advice on addressing the entire pensions issue (and not just private sector pension coverage) from the ESRI, IFAC and/or NTMA, as well as the advice of external consultants not on the public payroll.

The AE scheme should be the first step taken to bring equivalence between public and private sector pensions according to the Revenue's pensions and tax evaluation criteria. DEASP should commit to elimination of the apartheid between public and private sector with a fixed period of time.

Despite exchequer pensions amounting to more than €2.7bn annually, only one department details its pensions expenditure as a separate vote. The practice of analysing departmental pensions as a separate vote should be extended to all departments beyond the Department of Defence.

National Minimum Wage and the "Jobs Kill Zone"

Ireland continues to have the second-highest National Minimum Wage (NMW) in Europe (see figure 2). For several years now, this has been increased on an annual basis, without reference to underlying increases in cost of living. There appears to be a confusion in Ireland about what a NMW is designed to achieve; and the concept of a 'living wage' is frequently used as an analogue or used as an alternative baseline to the NMW.

Raising the NMW is a political cop-out from the more difficult issue of controlling the cost of living in Ireland; something for which successive governments have abdicated responsibility to the private sector. Ireland is the second most expensive country to live in within the EU, after Denmark (see figure 3). This would be bearable for the populace if our public services were as developed as those in Denmark, but they are not. It is noteworthy that Denmark has no NMW.

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Figure 2: NMW in the EU (Source: Eurostat)

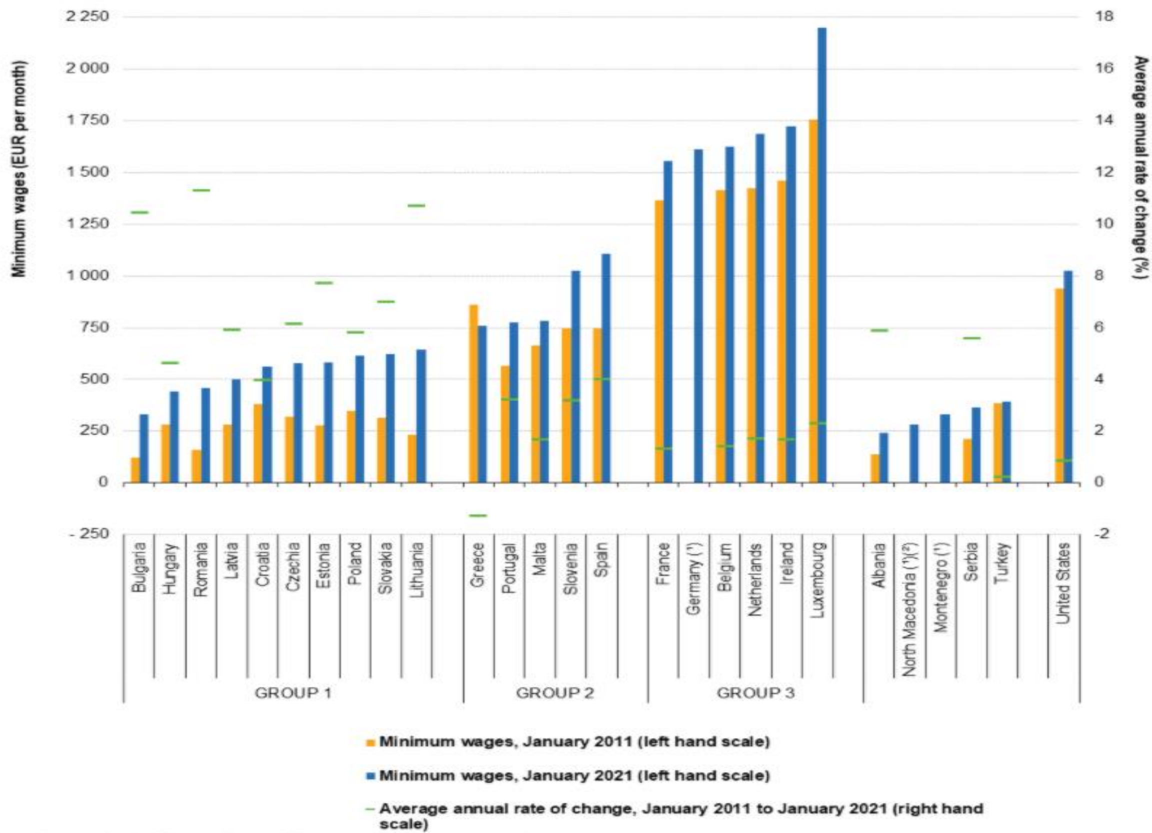
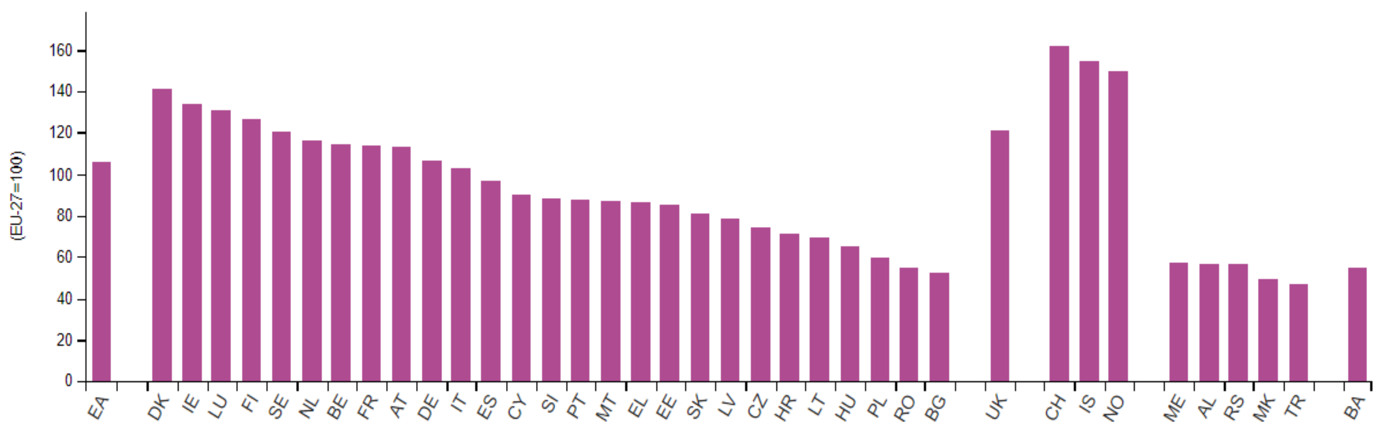


Figure 3: Consumer Prices EU 2019 (Source: Eurostat)



Source: Eurostat (online data code: prc_ppp_ind)

eurostat

We have observed the annual NMW revision process become a sterile, adversarial process, where the objectives of a NMW have been forgotten, and the sectoral responses have become stereotypical. Worse, we know from experience among member companies that raising the NMW may, in some circumstances, be counter-productive to the interests of the low pad. This sounds counter-intuitive, but is based on the real-world interaction between our social insurance, childcare, medical care and social housing systems. This problem is particularly acute in the income range from €18,000 to €30,000, which we have called the "Jobs Kill Zone. In our submission[28] to Government, we have made four key recommendations which would be far more meaningful than a few cents added to the NMW, or indeed the introduction of a so-called "living wage."

1. Adjusting PRSI to eliminate the very high marginal rate on additional income in the PRSI Transition Zone from €18,304 to €22,048 per annum.
2. Setting the basic rate for qualifying for the medical card at more than 30% above the comparable Jobseeker's assistance rate.
3. Replacing the child element in Jobseeker's payments and all other welfare schemes by substantially increasing, (up to doubling) Child Benefit, phasing out Working Family Benefit, and at the same time making the Child Benefit taxable
4. Significantly increasing the income thresholds for access to social housing. Reform or remove the link between income and local authority rent.

Optional Unemployment

This is a difficult and contentious issue, but we believe it exists, especially where there is a capacity to work in the grey economy. It is very difficult, but not impossible, to isolate. In Budget 2002, the then "Unemployment Benefit" was increased from £77.50pw (€98.40) to €118.80[29] [30] This increase of 21% in the benefit rate produced a one-year increase in the unemployment rate of 13%. This occurred at a time of full employment colloquially known as the "Celtic Tiger." Unfortunately, we must conclude that at least some element of this increase was unforced by economic circumstance.

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[28] Jobs Kill Zone
[29] https://assets.gov.ie/31645/905d6f46fc7b4063b15e5fc6d31ccd2e.pdf
[30] https://assets.gov.ie/31643/747d413bb5984f7da5aa634a6c411382.pdf

Upward-Only Rent Reviews

After wages, rent is the next largest cost for most businesses. In many cases, companies are currently paying rents that have little or no correlation to the market value of their property. Rents in Ireland are almost twice the international average. The only legal way out of UORR is to put a business into examinership, a process too expensive for the majority of businesses.

Despite the abolition of UORRs on new leases,[31] extant UORR lease contracts have remained in place. At the time of original legislation, the Government of the day cited constitutional issues[32] for their inability to ban historic leases. Interestingly, when the issue of spiralling domestic rents become a political issue, these constitutional issues evaporated; the establishment of Rent Pressure Zones debunked the myth of a constitutional bar to intervention in commercial rents. UORRs are an anachronism, for which there are many modern market-based alternatives. They continue to exert a drag on high street retail at the very time that sector is under immense pressure from online. As NAMA is being wound down, it is likely that the Government will face less opposition should it decide to ban all UORRs.

Reform of this issue has never been timelier, as lease agreements are likely to be the proximate cause of insolvency for most of the businesses that enter insolvency as Ireland exits the Covid-19 pandemic. With commercial vacancy rates in Henry Street approaching 30%[33] there will never be a better time to tackle this issue.

Social Progress Indicator

Despite the Covid-19 pandemic and other societal challenges, Ireland remains a relatively good place to live compared to some of its peers. Despite this, political discourse is regularly suffocated by cries that suggest Ireland is a third world country with public services to match. We therefore need an objective, politically neutral basis on which to identify those areas where improvement is, in fact, required.

ISME therefore considers it essential that Ireland develops a Social Progress Indicator, hopefully agreed through the National Economic Dialogue process, which would contribute far more to the budgetary debate than an endless discursion on our GDP and our GNI*.

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[31] https://www.ucem.ac.uk/wp-content/uploads/2016/01/Irish_Rent_Reviews.pdf
[32] http://www.justice.ie/en/JELR/Pages/PR11000247
[33] https://www.irishtimes.com/business/retail-and-services/henry-street-vacancies-to-hit-31-as-traders-seek-urgent-action-over-decline-1.4552581

SUMMARY OF ISME PRE-BUDGET SUBMISSION RECOMMENDATIONS

TAXATION

- Implement ISME's 18-point tax reform.
- Update and reform the current ARV calculation system for commercial rates, and reform of the LPT system
- Use the taxation system to incentivise a Basic Business Qualification at QQI level 6 for every business owner and manager.

SPENDING

- Significantly boost Covid-19 supports for the SME sector, particularly via direct grants.
- Implement tax policies that align with, and encourage, private sector expenditure on the green economy.
- Divert spending away from the university sector towards skills-based, vocational and life-long learning.

OTHER

- Conduct an immediate review of indigenous industrial policy to reduce our dependence on foreign-owned multi-national corporations.
- Reintroduce the Statutory Redundancy Rebate (or remove the 0.5% employers' PRSI levy which funds it).
- Regulate peer-to-peer lending in Ireland.
- Reduce the public-private sector pay gap to 10% by 2025.
- Establish a standing Public Service Pay Commission.
- Ban all (including historic) upward-only rent reviews.
- Stop increasing the NMW, introduce measures that eliminate the "Jobs Kill Zone" instead.

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