



Ibec submission to the National Reform Plan

March 2016

Key messages

1. Ireland needs to ramp up investment: Increases in capital spending under current plans will be backloaded until 2019 – with most projects unlikely to be completed before 2022 at the earliest. By this time, it is likely Ireland will have critical infrastructure deficits across a number of areas – having seen over a decade of underinvestment relative to any international or historical norm. In the face of the potential impact of Brexit it would be a mistake for the Government to row back on existing funding allocated to public investment or infrastructure from 2018 onward. Infact, it should begin to ramp up public investment now in order to reach 4% of GDP by 2020. In addition, public expenditure on innovation will need to be increased significantly to bring Ireland anywhere near either EU per capita norms or our targets as set under EU2020.

2. Ireland's narrow tax base with high marginal rates is a barrier to high skilled workers: The high marginal tax rates necessitated by the extreme progressivity of our system no doubt have distortive effects for Ireland with marginal rates of almost and over 50% for large cohorts of workers being a real challenge for Irish firms creating high value jobs and rewarding skilled workers. Our tax base should be broad based with highest marginal rates of around 45% and entry point to the top rate should be indexed to wage growth.

3. Action is still needed to overcome low labour market participation: Although employment has increased substantially and short-term unemployment is now within reaching point of pre-crisis levels Ireland cannot rest on its laurels when it comes to labour force participation. We still lag the UK and other EU15 countries significantly. Ireland has one of the lowest at risk of poverty rates for those in the workforce, where poverty occurs it is almost exclusively as a result of a lack of employment opportunities. Barriers such as childcare and activation must be targeted at those groups for whom intervention would be most effective.

1. Intro

Ibec welcomes the opportunity to input to the National Reform Plan for 2017. This submission takes places in a context much changed from previous submissions. The confluence of strong growth in the US and UK, a benign global environment, low interest rates, falling oil prices and favourable exchange rates played a large role in Ireland's recovery. Recent developments have brought increased risks to each of these factors. Employment rose by 3.3% (65,100) in Q4 of 2016 underlining the positive jobs momentum which carried the economy through to the end of the year. Importantly total employment excluding the construction sector is now 3,400 higher than its peak levels and short term unemployment is down to levels not seen since early 2006. These positive figure reflect the continued normalisation of the construction market and a record year for FDI employment in particular.

Brexit, threats to globalisation and political uncertainty in Europe will dominate the landscape in 2017. Economic momentum over the coming years will depend more on sensible domestic policy choices, we can no longer depend on external tailwinds. In this context this submission sets out our views on a number of key domestic policy areas addressed in some detail in the recent European Commission country report and suggests recommendations for improved policy.

2. The macro-context

The short term situation

The Irish domestic economy has entered a period of turbulence with some forward momentum behind it. We expect growth in the economy to have reached 3.7% in 2016 on the back of significant growth in domestic demand. Q4 employment figures and early 2017 retail sales have done nothing to suggest this momentum is weakening for now. We cannot afford to be complacent, however. The indigenous exporting side of the economy, however, is entering a difficult period. A weak Sterling and uncertain external environment are weighing heavily on exposed firms. The FDI community is thriving but mood music in the US has the potential to slow the flows of new investment to Ireland over the coming years. Our expected growth rate of around 3% in 2017 is still is well above the European average but there are significant downside risks now on the horizon.

Indigenous exporters

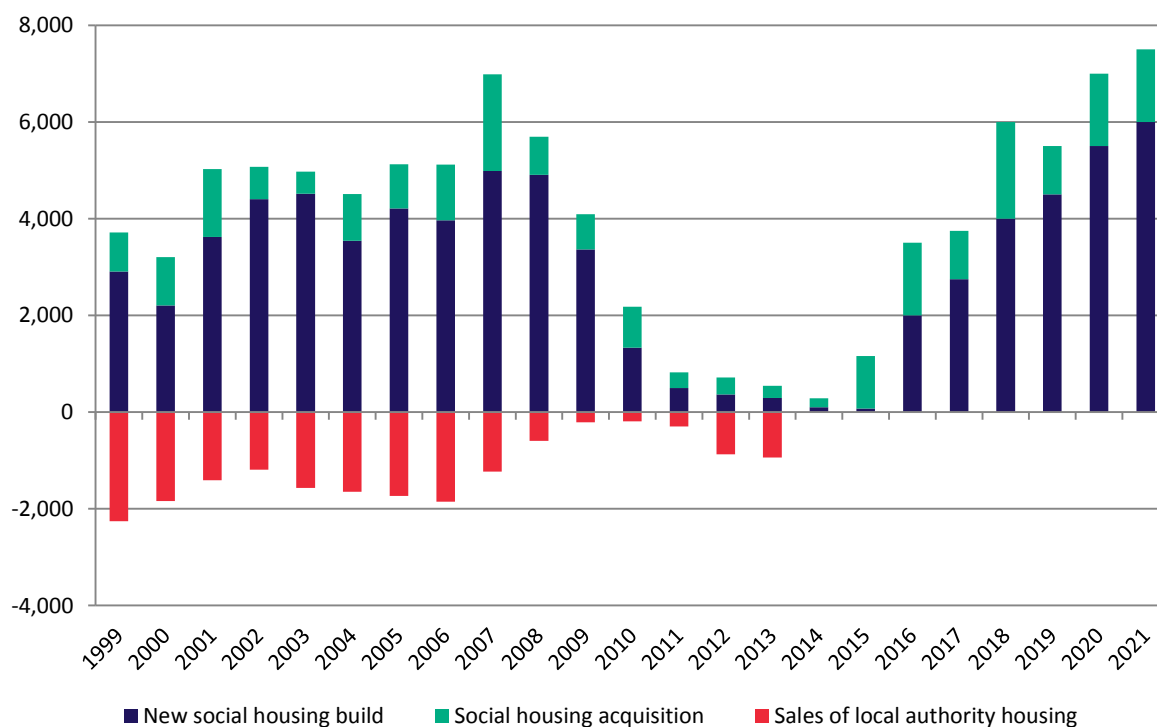
Total goods exports rose by 4% (€4.5 bn) annually in 2016. This, however, disguises a more worrying trend. When the two high-tech sectors of pharma and electronic equipment are excluded exports fell by over €2 billion or 4.6% annually. The depreciation of Sterling had a significant role to play in this slowdown. The value of Irish food exports to the UK is down 7% year-on-year. This accelerated to 12.5% in July and August before some recovery in September. Despite Sterling's weakness Irish exports overall will continue to grow, albeit at a slower pace in 2017.

Industrial production figures for 2016 have been weaker than recent years with the drop off since summer a particular worry. Output in traditional manufacturing fell by 0.8% in 2016 with modern manufacturing rising by little over 1.1%. Food production has been the driver of the weakness in traditional manufacturing. Food output fell by 2.2% annually and turnover was down by over 3% (around €450 million). The pace of deterioration has accelerated since the Brexit result in June with output down 4.3% in H2. This has important implications for rural areas. About 10% of turnover in the sector is spent on wages and salaries and 40% on intermediate purchases from the primary agri-sector. As such the direct loss to incomes in rural areas (on and off-farm) is likely to be in the region of half of the loss in turnover.

Investment and the consumer economy

Business investment, which has driven investment growth in recent years, dropped off significantly since early 2016. Given the poor industrial production numbers and growing global uncertainty it is likely that some softening in business investment will continue into 2017. Despite this we expect overall investment to continue to grow on the back of increasing construction activity across both the housing and commercial categories. Housing investment is on track to grow by 20% in 2016 and higher in 2017, albeit off a low base. There is significant upside potential to these figures if the new ambitious target set for social housing in the Rebuilding Ireland plan exceeds expectations. Early signs are that it may well deliver. Even with this, however, the market will take a significant amount of time to deliver the housing needs of a growing urban population.

Fig 1: Rebuilding Ireland social housing builds targets



Our expectation is that consumer demand will end up growing in the region of 3.5% for the full year of 2016 on the back of strong wage and employment growth in the economy. For 2017 there are two duelling dynamics underpinning growth in consumer spending – firstly consumer fundamentals will remain very strong. Employment growth will continue its positive course, the population is growing quickly, taxes are down, inflation is low and the majority of firms expect to give pay increases next year. On the other hand, however, the uncertainties facing exporting indigenous companies present some downside risk. Despite this our overall assessment of the consumer economy is very much a positive one of robust growth underpinned by strong fundamentals. As such we expect healthy consumer spending growth of around 3% in 2017.

Summary of economic outlook

Over the coming years the durability of the economic recovery seen in recent years will come under serious pressure. In recent years we have drawn attention to the fact that Ireland's re-ascent after the crisis in 2008 was aided by fortuitous tailwinds. The confluence of a benign global environment, strong growth in the US and UK, low oil prices, favourable interest and exchange rates allied to the continued success of our globalisation driven business model played a major role in our recovery. The current global environment has brought growing uncertainty about each of these factors. Our external facing sectors are clearly experiencing a slowdown and domestic demand momentum can only pull the economy along for so long. As such we expect growth to drop off in just over 3% in 2017.

3. Key issues

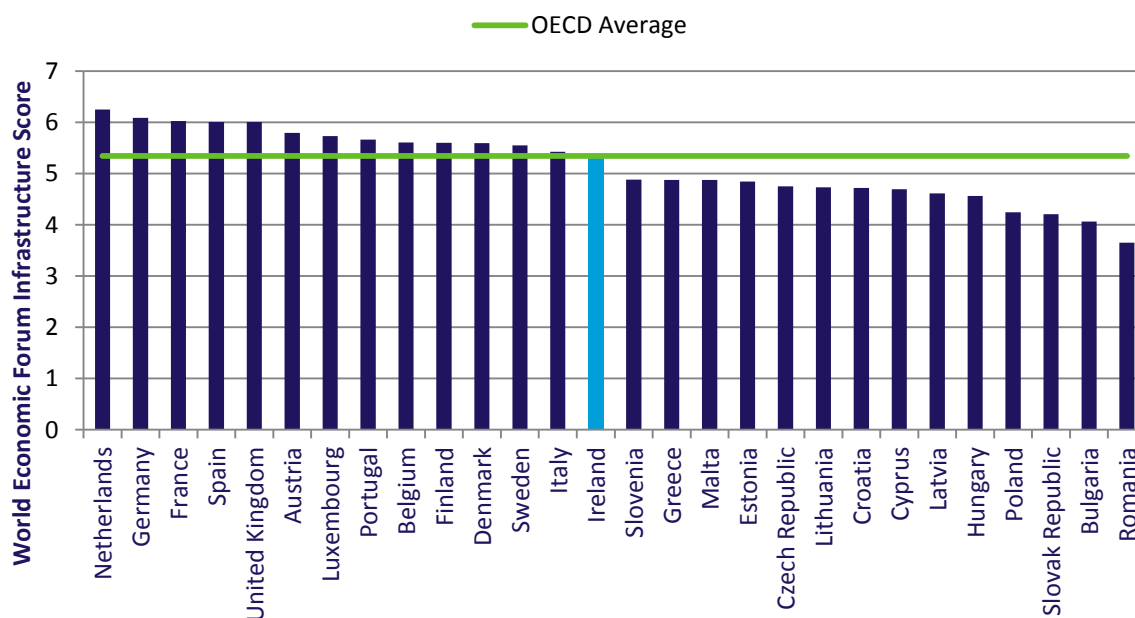
3.1 Capital investment and the need for integrated planning (NPF)

i. The capital budget

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

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

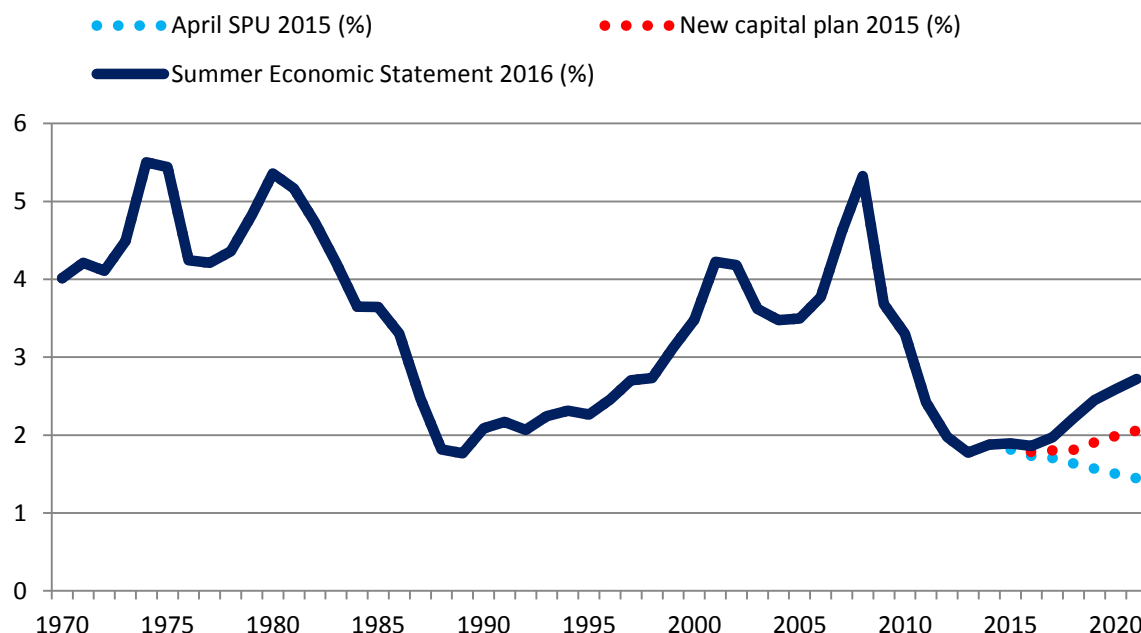
Fig 2: WEF infrastructure score



The reality of the low level of public investment was laid bare in recent reports by both the European Commission and the Fiscal Advisory Council which showed the vast majority of public capital spending would be committed to maintenance and repair with little going to new build. As a result, the total stock of public infrastructure in Ireland will, at best, remain at relatively low levels. This is at a time when Ireland is facing into

rapid demographic growth and overheating pressures in transport, education, water, broadband, health and other public infrastructure which are affecting Ireland's competitiveness.

Fig 3: Public capex % of GDP



Under the fiscal rules it will be difficult to enhance public investment sufficiently in order to meet the demographic or economic pressures Ireland will come under. Increases in capital spending under current plans will be backloaded until 2019 – with most projects unlikely to be completed before 2022 at the earliest. By this time, it is likely Ireland will have critical infrastructure deficits across a number of areas – having seen over a decade of underinvestment relative to any international or historical norm. In the face of the potential impact of Brexit it would be a mistake for the Government to row back on existing funding allocated to public investment from 2018 onward. Infact it should begin to ramp up public investment now in order to reach 4% of GDP by 2020.

This is the only prudent course at a time when interest rates are at an all-time low (allowing for the cheap carry of debt financed cash reserves) and when the State has significant liquid value built up in both cash, ISIF and the retained value in the pillar banks (cumulatively worth in the region of 15% of GDP). The new capital plan instead should see some provision made in order to aid fast tracking of planning and procurement for key projects.

To do this Government will need to continue to press for changes to the rules at a European level. Ibec supports the fiscal rules for day to day spending and taxation (the current budget). However, the structure of the rules allied to the short-term horizons of governments, bias political decisions toward short-term quick fixes which end up being more expensive in the long-run (for example recurring fuel subsidies over household retrofitting) but are expedient.

Specifically, Ibec would like to see investment targets (resembling the R&D investment targets set for all EU countries under the EU2020 process) with the aim of increasing investment broadly across the single market. Secondly, the current smoothing period of 4 years for capital spending under the fiscal rules has no evidentiary basis. Capital allowances for taxation purposes are typically longer than 8 years and corporate accounting

allows depreciation across the lifetime of the asset. The depreciation period under the fiscal rules should be extended beyond ten years at a minimum.

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

To ensure better value for money for the taxpayer from these projects it would be sensible to establish a national infrastructure advisory council reporting to the Oireachtas which would advise on appropriate projects and the efficiency of public spending.

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

Recommendation 1:

- Ireland's capital budget should target a level of 4% of GDP by 2020. This should be front-loaded to deal with increasing competitiveness challenges.
- Ireland will need to continue to look for more favorable treatment of investment under the EU's fiscal rules.

3.2 The tax base and high skilled workers

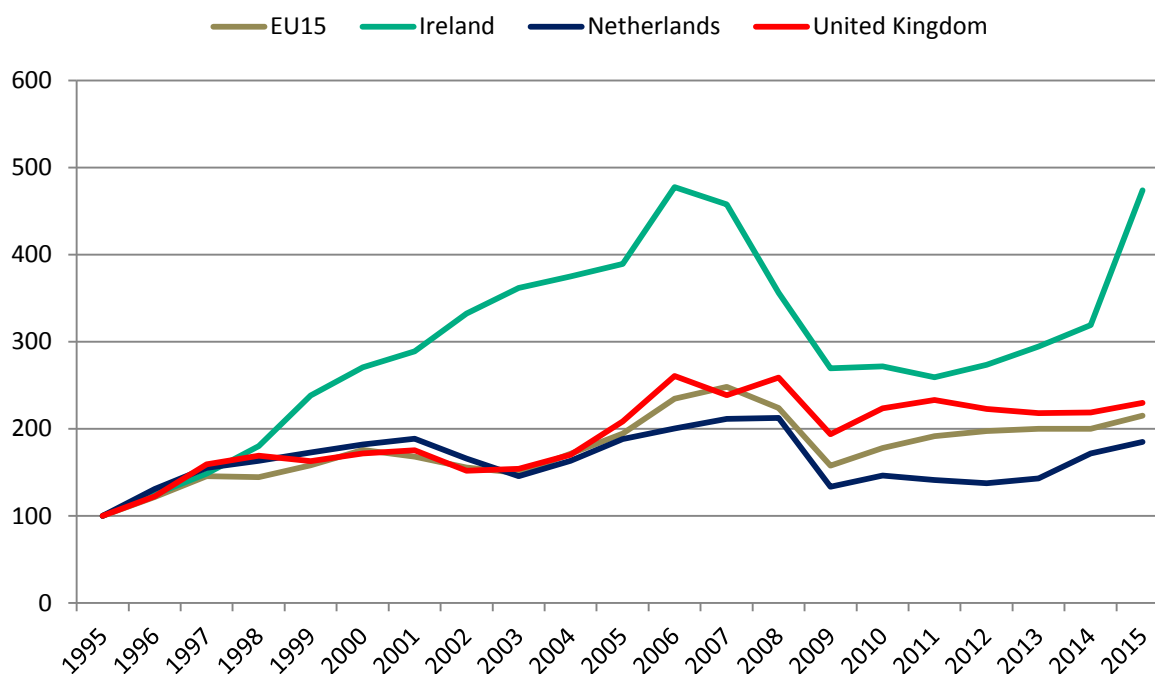
Ireland is in a better position to weather the uncertainty of Brexit now than it has been over previous years. Our fiscal position has improved rapidly with debt ratios now reaching developed world norms and the state reaching a primary surplus in 2015. By 2018 it is expected that we will have reached our medium term objective under the fiscal rules albeit with some timing uncertainty following the Brexit vote. The government has set out its intention to run a significant primary surplus (government revenue minus non-interest spending) over the period from 2015 to 2021. Additionally, given the average interest rate of government debt (3%) is lower than expected nominal growth rates of GDP both the debt ratio and the relative cost of debt servicing should fall significantly over the coming years.

i. Corporation tax

Ireland's corporate tax base has become increasingly volatile in recent years. This was underlined by the 26% headline GDP growth figure and strong CT returns growth witnessed in 2015. The impact of this volatility on the overall tax base is the product of the relatively small and hyper-globalised nature of the Irish economy its danger in terms of Ireland's fiscal position is compounded by the narrowness of our tax base compared to most developed states.

Some volatility in corporation tax take is not to be unexpected given the fact that a relatively small number of companies pay the vast majority of the tax take. The top 1% of companies by net income, of which there are only 450, paid 83% of total corporation tax. The top 10% (circa 5,000 companies) paid 97% of the total tax take; while the remaining €122 million (3%) of the €4.07 billion tax take was paid by 90% of companies. This volatility intensified however in 2015 and is expected to continue in the coming years.

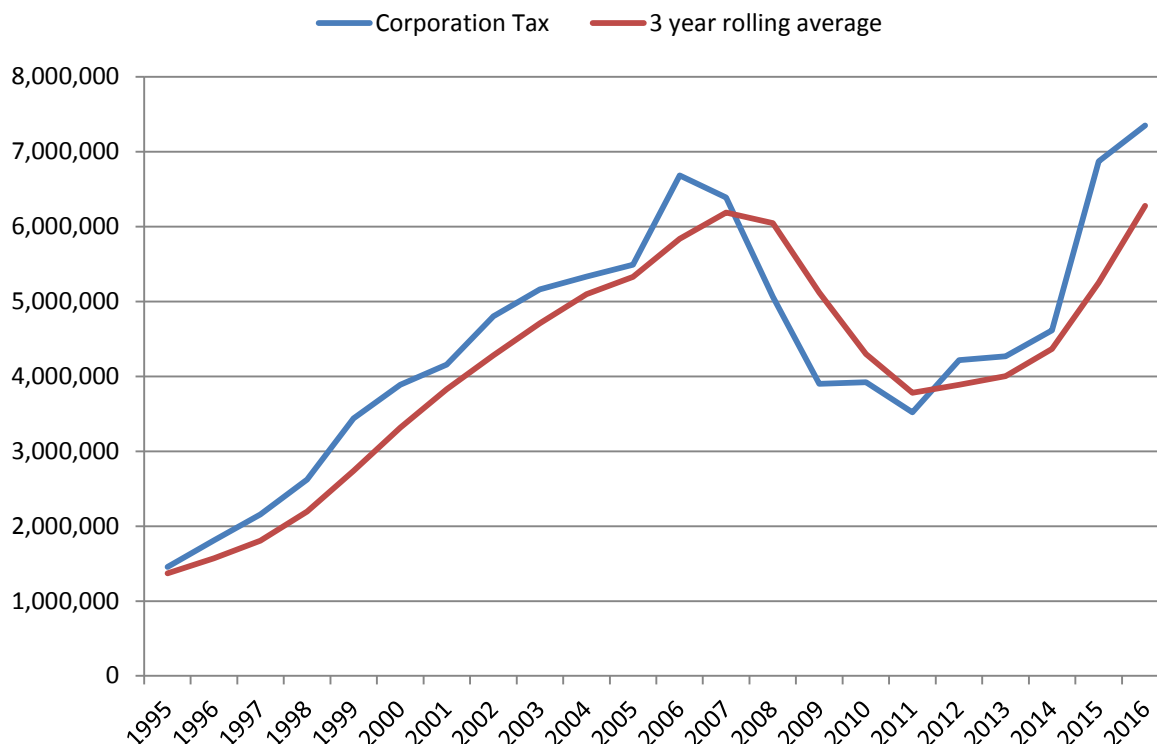
Fig 4: Index of corporate tax income, 1995 = 100



This extreme concentration of corporate taxation in a small number of, mainly multinational, firms' means that policy issues affecting them can have serious fiscal consequences. This is increasingly the case in the context of growing global competition for FDI from countries such as the UK and ongoing policy uncertainty emanating from the US. The current signs are that changes in the international tax environment will benefit Ireland significantly. Changes to international corporate tax through BEPS have resulted in some windfall corporate tax

gains for Ireland. Feedback from our member suggests that there is no immediate prospect of those gains receding but that they may become more volatile in the future. There are no guarantees in this, however, and building those gains into the base of current government spending will leave the state open to fluctuations in the tax base in the future.

Fig 5: Irish Corporation tax receipts and their 3 year rolling average 1995 to 2016



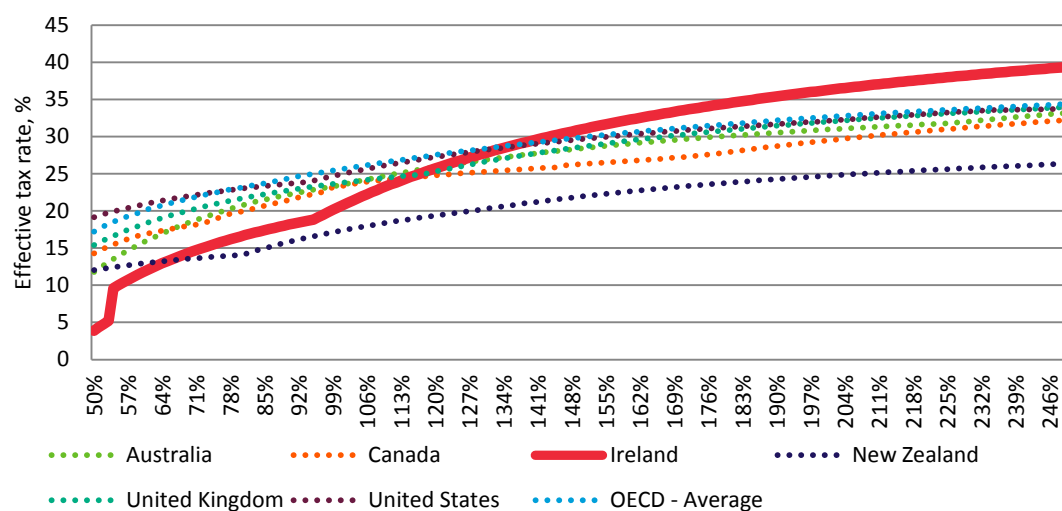
As such it is Ibec's view that the gains from burgeoning corporate tax receipts should be ring fenced for the investment the country will desperately need in the coming years rather than built into the base of current spending. This could be done by putting in an investment account any excess in in year CT returns which are in excess of the three year rolling average of CT receipts – in effect smoothing the level of Corporate tax which can be built into the base of current spending. On average this would have meant ring-fencing around 9% of corporate tax receipts since 1995.

Recommendation 2: Windfall corporate tax gains as a result of BEPS should not be built into the base of recurrent current spending but instead used for once-off investment projects

ii. Income tax

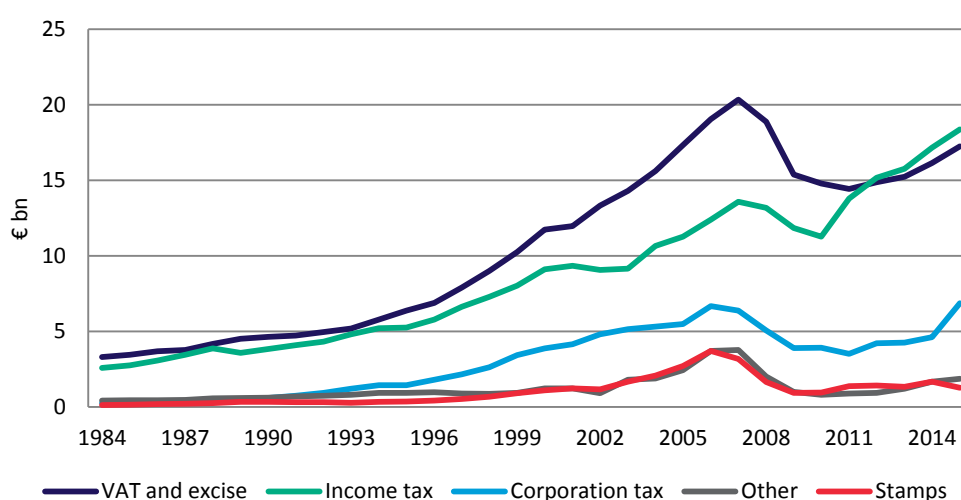
The debate around income tax has become even more prominent in recent years as the income tax take increased in order to fill the hole left by the collapse of the construction industry. Unfortunately the focus of the debate about tax and spending is often very narrow, centring on beneficiaries from incremental changes. Commentary on tax reform is more often than not centred on 'who got what' rather than the economic merits of policies. This often leads to a loss of perspective on how the system functions as a whole or what impact the structure of our tax system has on the economy. This is a continuation of the type of debate which has left us with an income tax system which looks like that of no other developed economy, characterised by a narrow base and both very low and very high effective tax rates at each end of the income distribution.

Figure 6: Effective income tax and PRSI rates by % of national average wage, single earner



In recent years the income tax share as a proportion of total taxation has shifted upwards significantly. Income taxation in Ireland, at 40% of total taxation, is the 5th highest in the EU. This shift toward labour taxation is a far from ideal situation given the weight of evidence which shows that excess labour taxation slows economic growth through its negative effects on productivity and labour market incentives. Recent work by the Department of Finance (O Connor, 2013) and the OECD (2010) have shown that there are significant positives for Ireland, when it comes to economic growth and employment, in shifting the burden of taxation away from earned income and onto less distortive areas such as immovable property or user charges. Some of this shift will happen naturally over the coming years as recovery in the consumer economy and asset prices leads to greater revenue from consumption and capital taxes. Over the long term we think that income tax should account for around 1/3rd of the total tax base. Difficulty in implementing and maintaining less distortive taxes such as water charges and the property tax is a worry from a business point of view and will ultimately lead to further distortion of the labour market.

Figure 7: Irish tax receipts by source, 1984 - 2015



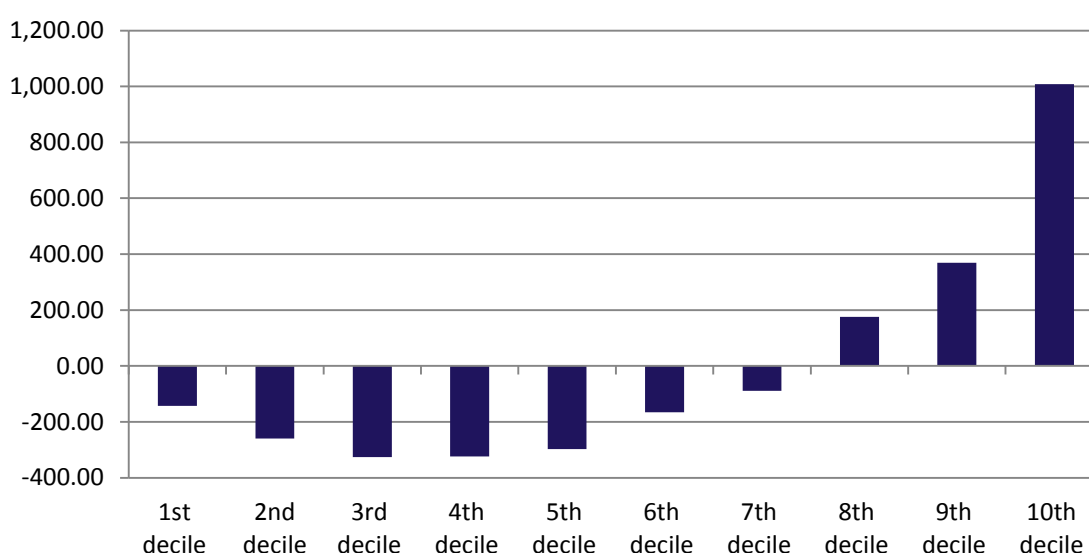
While Ireland's income tax system is not particularly notable at an aggregate level it is unique internationally, in a number of ways, when it comes to the distribution of its burden among different income groups. Firstly, it is extremely progressive; the second most progressive in the developed world. Even allowing for other less

progressive taxes such as VAT (which is distributionally flat measured as a % of household expenditure) Ireland's tax and benefit system remains by far the most redistributive in the EU.

State intervention in Ireland lowers the Gini coefficient of measured inequality by 35%, compared to an EU average reduction of 15.7%. This is mainly a result of Ireland's initial high household joblessness, its relatively low employment rates, its narrow income tax base and the resultant heavy lifting done by the tax and transfers system. As various bodies have acknowledged, however, this massive redistribution does not come without both economic and social costs. A balance must be struck between equity and efficiency; from a business point of view the Irish tax system is less effective than it could be.

In this context the narrative of Ireland as low income tax country depends heavily on what type of household you live in. The best way to illustrate the progressivity of the overall system is contained in figure two which shows the net benefit or contribution (through direct tax and benefits) to the exchequer by the average household in each income decile. On aggregate only the top 3 deciles are net contributors to the exchequer, while households in the bottom 7 deciles on average receive more from the state than they pay in taxation.

Figure 8: Net average weekly household direct exchequer contributions by net disposable household income deciles, 2014



The narrowness of the income tax base in Ireland is a particular feature of our system which means that the balance of the burden for the state's tax takes falls on a relatively small number of households. Under Ireland's tax credit system 32% of all income tax cases (either single or jointly assessed) end up paying neither income tax nor USC. This compares poorly with our nearest neighbour the UK, where only 11% of income earners are exempt from income taxation. To correct for this narrowness of our income tax base there is a very quick shift upward in effective and marginal tax rates for earners at just above the average wage.

Ireland is also an outlier in terms of its low taxation on low income earners with a person on €25,000 paying about 2/3rds of the average tax for similar earners in other developed countries and less than 40% of their equivalents in Northern European countries such as Germany or Denmark.

At just below the average wage (€35,700) Irish effective tax rates begin to rise very quickly as a result of a marginal tax rate of 49.5%; this is the 2nd highest in the developed world at average earnings and kicks in at a level which is the lowest in the OECD (barring some flat tax regimes). At earnings of 120% of the average wage or just above €39,000, Ireland surpasses the OECD average effective income tax rate. The effective income tax rate for a person earning 167% of average wage (equivalent to around €55,000) is the 8th highest income tax rate in the developed world. By 250% of average wage (€81,500) Ireland has the sixth highest average income tax rate in the OECD at 34.6%, five percentage points higher than the OECD average.

The high marginal tax rates necessitated by the extreme progressivity of our system no doubt have distortive effects for Ireland with marginal rates of almost and over 50% for large cohorts of workers being a real challenge for Irish firms creating high value jobs and rewarding skilled workers. Recent research in Denmark has provided clear evidence that mobile skilled workers are affected by marginal tax rates at the top of the earnings distribution (Kleven et al, 2013). The evidence points to a very large elasticity of migration with respect to the net-of-tax rate of between 1.5 and 2. That is a 1% increase in the marginal tax rate reduces inward migration of high skilled workers by between 1.5% and 2%.

Given that there are clear negative economic consequences to maintaining high marginal rates on work their continuance could only be justified on the social grounds that the proceeds from higher taxes can be redistributed into better services. Comprehensive research, in recent years from the UK, however, suggests that marginal rates at levels seen in Ireland may not be revenue maximising at all. The Mirrlees review of taxation in the UK suggested a revenue maximising top marginal rate (including indirect taxes) of 56% between €1 gross pay and consumption of that gross pay – or in other words between getting your pay-check and spending it. This in an Irish case would include income tax, USC, PRSI, VAT along with a raft of other taxes depending on how you spent your money. Given that revenue figures suggest the average rate of VAT on consumption to be 15% then it is likely (as we have shown in Ibec policy brief 03.16) that over half of workers in Ireland are facing marginal rates well in excess of 65% on the same journey between receiving their gross pay and consuming it.

Given the similarity of the income distributions and institutional structures between Ireland and the UK it is reasonable to think higher rate payers will have similar elasticities to income tax here. This would imply that if Ireland were to reduce its top marginal rate of income tax (the €70,000 rate band) to 45% it would incur very little loss in revenue at all. Independent analysis of similar tax changes in the UK by both HMRC and the independent Office for Budget Responsibility (the UK's version of the Fiscal Council) concluded that little or no revenue was lost by reducing the top rate of tax to 45 percent on the back of this research.

Recommendation 3:

- Revenue buoyancy and base broadening measures should ensure labour taxation only constitutes about 1/3rd of overall revenue
- The income tax system should be broad based with top marginal rates (inclusive of USC and PRSI) of around 45%
- 50% of workers' already pay tax at the 49.5% marginal rate or above. The entry point to these top marginal rates should be set at a level at least above the average wage and indexed to wage growth to avoid fiscal drag as the labour market tightens

3.3 Labour market participation – childcare and activation

i. Childcare

Female labour market participation is much lower than for males in Ireland, as in many other countries. A myriad of issues can influence an individual's decision to participate in part-time or full-time employment but two issues, less about choice and more about the unintended consequences of childcare and personal tax policy decisions, result in penalties which hamper females with children in the labour market.

We know that:

- Maternal employment rates are lower than for women as a whole and many would like to work or work more but are constrained by family responsibilities;
- Entry cost effects from childcare and tax burdens reduce the net reward from employment with childcare costs representing the largest additional costs associated with taking up employment thus acting as a disincentive to work especially for second earners in dual earning couples;
- Ireland has a relatively low level State funding for childcare but the second highest direct payments to parents of any OECD country because of child benefit;
- Child benefit reduces female labour market participation but affordable and available childcare services increase it;
- A more neutral tax treatment of second earners in a family compared with single earners yields increased female participation;
- Forced absence from the labour market for females can also incur a “motherhood penalty” which can contribute to a gender pay gap and less gender balance in decision-making roles.

An increase in female participation could help boost growth and mitigate the downward pressure on labour supply and the impact of a shrinking workforce and skills shortage. Evidence from the OECD shows that on average, the projected gain from full convergence in participation rates is an increase of 12.4 % in GDP per capita by 2030 in EU-21¹. Addressing this challenge could also contribute to reaching the European target of a participation rate of 75% of the population between 20 and 64 by 2020.

Failure to urgently address this situation will increase the gender balance issues facing women in business, deprive business of the financial, innovation and problem-solving benefits of diverse teams, cost the exchequer in terms of benefits payments and lost tax revenue, put families at risk of poverty and lead to stifling of Ireland's long-term economic competitiveness² and growth.

¹ 'Closing the Gender Gap: Act Now', OECD publication, December 2012.

² <http://www.competitiveness.ie/Publications/2016/ICS-2016.pdf>

Challenges

Currently in Ireland, despite an increase in investment in this area, the service provided in early childcare and education is not consistently appropriate for the children or parents looking to avail of it, with high costs and variable quality and availability core to the problem. Ireland ranks 18th in the World scores which rate quality, affordability and accessibility of early childhood education services (Ranked 13th for availability, 29th for affordability and 14th for quality)³.

Cost of childcare

The cost of early childhood care and education in Ireland for parents is among the highest in Europe and directly impacts labour market participation. It is a barrier for families across a range of salary levels, not just those on lower incomes. For households with children, childcare costs represent the largest additional cost associated with taking up employment. The implicit cost of returning to work amounts to 90 per cent of potential earnings in Ireland compared with 57 per cent in the OECD⁴. Costs are influenced by the labour intensive nature of childcare and education, the ratio of adult to child as well as the fact that unlike other countries parents need to pay almost the entire childcare costs due to low state investment. Successive governments have increased spending on childcare and last year invested 0.5% of GDP in early childcare and education. However this is compared to the average OECD spend of 0.8% of GDP or the international benchmark set by UNICEF at 1% of GDP.⁵ Despite the investment formal childcare remains out of reach for many.

Econometric studies note the impact of childcare costs on income gain as central to female decisions to leave or remain in the workforce. Such costs can result in disincentives to work, particularly for a second earner in a dual earning couple, as it does not pay to have a job as work cannot pay enough to compensate for the high cost of care. Conversely childcare subsidies and public delivery of childcare has boosted female labour market participation in OECD countries⁶. While Ireland has a relatively low level State funding for childcare, we have the second highest direct payments to parents of any OECD country because of child benefit. These payments however are poorly targeted, with 17% of payments or €330 million going to households who earn more than €100,000 a year. So while low income families receive a lot of support, childcare is increasingly beyond the reach of the “squeezed middle” families⁷.

Recommendation 4: Child benefit payments should be means tested so that they remain the same for low income households but taper off gradually for higher income households (from €80,000). This has the

³ Economist Intelligence Unit (2012) *Starting Well Index*.

⁴ National Competitiveness Council (2016). Ireland's Competitiveness Scorecard

⁵ *Report of Inter-Departmental Working Group: Future Investment in Childcare in Ireland*. Department of Children and Youth Affairs

⁶ IMF (2016). *Individual Choice or Policies? Drivers of Female Employment in Europe*. IMF Working Paper, WP/16/49/

⁷ Truss, E., (2012). *Affordable quality: new approaches to childcare*. CentreForum

potential to save the Government €200-€500 million depending on the cut off point for tapering which could be redirected into services .

Adult to child ratios

Ireland's mandatory child-adult ratios are some of the lowest in Europe, with huge variability from country to country e.g. in France the ratio is 1:8 for two year olds compared to 1: 5 in Ireland, while Denmark, Germany and Sweden do not have mandatory ratios for any age group. These tight staffing rules increase costs for parents and reduce earnings for employees thus undermining the attractiveness of the sector. This has implications for the continuity of service for parents as well as the individual providers. Based on the variability internationally if staff held higher qualifications (NFQ Level 7 and above) they have engaged in greater levels of training and thus theoretically supervision levels could be raised to enable larger ratios. This should result in better quality and professionalism through greater education levels, attract higher paid staff to the sector and may also make the service more affordable and available.

Recommendation 5: Ibec recommends that greater flexibility is enabled within child: adult ratios whereby more highly qualified staff (NFQ Level 7 and above) can respond to higher numbers of children. In addition to the higher capitation grants this would provide a greater incentive for providers to encourage workers to obtain these qualifications and potentially lower costs for parents.

Availability

While there has been very welcome investment in the Early Childhood Care and Education (ECCE) area with the extension of the free pre-school year and the provision of the Community Childcare Subvention which provides affordable childcare for low-income families, the availability of subsidised early care and education still does not fit with most working parents needs. The ECCE Scheme provides early childhood care and education for children of pre-school age (aged over 3 years and not older than 5 and a half years) for typically 3 hours per day, 5 days per week, only during school terms. In Ireland as in Europe there is a significant 'childcare gap' between the end of adequately paid leave (maternity or parental) and the start of childcare entitlement or compulsory school age. If this provision was increased to include younger children (1-3 year olds) this could further bridge the gap for some parents and encourage them back into the labour market at an earlier stage.

While this free year goes some way to offset childcare costs often it is too short to suit even part-time jobs. If the duration was increased to four hours per day, this could facilitate greater access to part-time work. Similarly the Community Childcare Subvention only suits parents within close proximity to a participating service. Worryingly a recent report⁸ suggests that due to the costs of provision, providers are reducing the amount of non ECCE provision such as year round and care for children under three years. This would have

⁸ Early Childhood Ireland (2016). Doing the sums: The real cost of providing childcare

huge implications for the labour market participation of parents. A review of the current funding model may be required for both the Single Affordable Childcare Scheme and the ECCE programme.

Recommendation 6: Ibec recommends the extension of the Early Childhood Care and Education scheme to include children aged 1 to 3 years and to increase the duration to 4 hours.

The supply difficulties are not limited to the pre-school stage but also feature with children of school-going age. The current Irish school day does not reflect the needs of working parents and the availability and affordability of after-school and out-of-school hours care is an issue. There are fewer places available for children after the school day ends and the logistics of transporting children to a central location brings its own challenges. Again this affects both the participation of parents (particularly females) in the workforce and the nature of their participation. In Ireland there is currently no formal after-school care system in place that is regulated and there has been limited research conducted in this area. Currently after-school or out-of-school services are ad hoc, unregulated and often expensive. They can include full-day care during school holidays, delivery to and from school and meals. If out-of-school service utilised existing school buildings this could further reduce the complexity for working parents.

Recommendation 7:

- Ibec recommends the implementation of a regulated, formal out-of-school hours care system to nationally address the needs of working parents and the atypical work day.
- Provide out-of-school hours services in existing school buildings, making greater use of the facilities available out of hours and reducing the complexity of care for working parents

The introduction of the Single Affordable Childcare Scheme will offset the childcare costs in particularly for low income disadvantaged families but the amount invested will not lower costs significantly. It is hoped that the means tested subsidies will not have the unintended consequences of reducing the work incentive for second earners which could occur if the result of increasing hours or taking a new job actually reduces their benefits or takes them over the threshold thus costing them more and reducing their participation. The feasibility and possible benefits of a tax saver childcare voucher model to encourage the retention of females in the labour market should be explored. While the personal tax burden has started to reduce in Ireland in recent budgets, middle-income and higher-income earners still pay more tax than they did prior to the introduction of austerity measures. This may have implications for growth and productivity as it will become less attractive for employees in the “squeezed middle” to earn more or achieve a promotion as high personal tax levels are also incurred. While Irish workers on €55,000 pay more personal tax than Spain, the UK and Sweden, workers in Germany, the Netherlands and France pay more income tax but receive significantly greater benefits in areas such as childcare. Using a model similar to the travel saver commuting ticket, employees could receive childcare vouchers for eligible providers, tax and PRSI free taking the cost of the voucher from the gross salary and saving the employer a percentage of employer PRSI for administering the scheme. Beyond the specified

limits, parents would pay for childcare in the usual fashion. This scheme would meet the needs of parents already in the labour market, particularly those deemed the “squeezed middle” and could act to encourage them to remain in the labour force particularly those with more than one child, usually females, who have been identified as more likely to leave employment due to childcare costs.

Recommendation 8: Explore the feasibility and possible benefits of a tax saver childcare voucher model to encourage the retention of females in the labour market.

Risk of child poverty

The cost of childcare has significant impacts, both short and long term, on individuals, families and organisations. The household income is automatically reduced if a parent exits the labour market and this puts them at risk of poverty. This is a particular risk for women in lower-skilled jobs. Research⁹ found that women in low-skilled jobs reduced the amount they worked each week by an average of 18 hours after the arrival of their second child, compared to 5 hours less per week for those in skilled roles while women in unskilled jobs working more than 20 hours per week dropped by more than half. In total 60% of women with one child aged under four were working to some extent but the figures dipped dramatically when a second child arrived.

⁹ Centre for Economic Performance, London School of Economics 2016

ii. Labour market activation

Significant progress has been made on activation although the unemployment figures are still too high and despite the improved labour market situation long-term unemployment, youth unemployment, inter-generational jobless households and unemployment amongst people with disabilities all remain of serious concern. There has been some progress in the delivery of employment and activation services. The implementation of new engagement processes, jobseeker profiling, the establishment of an employer relations division, a reduced payment regime for people who do not engage with the system and the back-to-work family dividend are all positive developments. Employers are also more welcoming of the JobPath contracted employment service which supplements Intreo in delivering support to the long-term unemployed. However, despite the significant improvements there are inconsistencies in the quality of service. It is essential that these reforms are consolidated and that Intreo staff have the capacity, competence and culture to deliver services that meet the needs of clients.

Recommendation 9: Consolidate the reforms outlined in the Pathways to Work strategy and ensure that Intreo staff have the capacity and resources to develop their work.

Overall there is a need to meet those who are unemployed at the level of their individual circumstances whether labour market activation for them involves employment or education and training first. It is essential that they are appropriately matched with the right solution. There is a sizeable cohort of very low-skilled unemployed, distant from the labour market who require specialised interventions within education and training. Failure to do so perpetuates the cycle of insecure employment followed by periods of unemployment in the absence of upskilling opportunities. Strong career guidance from Intreo and close collaboration between Intreo and the Education and Training Boards to guide unemployed individuals is essential. While this works exceptionally well in some locations it is not consistent in all areas.

Recommendation 10: Ensure that Intreo and the Education and Training Boards have a formal and close collaboration process which is consistent across all locations.

The overall Pathways to Work programme or any of the individual elements within it cannot be separated from the impact of other policy initiatives (e.g. Action Plan for Jobs) or from the impact of wider economic developments, until rigorous and systematic programme of impact evaluations are completed'. These evaluations are necessary in order to identify what programmes work best, in order to prioritise the future allocation of scarce resources to maximum effect.

For example, a review of the JobBridge internship programme showed that 79% of candidates were employed directly and 64% are still in employment. Matched against a control group, an unemployed person had a 32% better chance of getting employment and sustaining it having gone on JobBridge.

Recommendation 11: Government should complete its programme of labour market impact evaluations. Where schemes fail to deliver, they should be radically reformed or replaced.

Recommendation 12: A replacement work experience scheme for JobBridge should be introduced.

The share of the population living in jobless households rose rapidly in the recession that began in 2008, and though it has fallen since 2012 in line with the overall level of unemployment, it remains above pre-crisis levels. The share of the adult

population resident in jobless households in Ireland is not abnormal by EU standards. However Ireland has a relatively high share of children resident in such households.

As the labour market tightens it is timely to consider changing the approach to working with unemployed people. At present where there are two or more adults in a household unemployed (or inactive) it is typically the case that the state only engages with the adult who is perceived to have been the 'primary' earner. This tends to ignore the employment potential of the other adults; greater attention to jobless households would be one way of addressing this gap.

Recommendation 13: Conditions for qualified adult dependants' payments should be aligned with the reformed conditions for lone parents' payments.

Given the uncertainties facing all economies, the ability to adapt our labour market activation policies to the prevailing situation is key. Individuals need employment security rather than job security as the job for life is available for so few. Organisations need to be able to adapt their workforce to changing economic conditions, matching skills needs, productivity and competitiveness in line with changing economic conditions. The concept of "flexicurity" promoted over a decade ago by the European Commission which looked at integrating and enhancing both flexibility and security in the labour market may now need to be revisited.

The four tenets of flexicurity were:

- Flexible and reliable contractual arrangements for employer and employee;
- Comprehensive lifelong learning strategies to ensure the continual adaptability and employability of workers, especially those deemed most vulnerable;
- Effective active labour market policies that help people cope with rapid change, reduce unemployment duration and ease transition to new jobs;
- Modern social security systems that provide adequate income support, encourage employment and facilitate labour market mobility.

While progress has been made under these headings further work is necessary if growth, jobs and social cohesion is a priority.

Recommendation 14: Explore the feasibility and possible benefits of the flexicurity model for the labour market.

iii. Research, Development and Innovation

Ibec shares the Commission's concern about the ongoing decline in public R&D intensity which will have a negative impact on the standing of Ireland's research base. In 2014, total spending on R&D was 1.5% of GDP. Strong nominal GDP growth means that we are likely to have fallen further away in the intervening period. Compared to other countries this share is very low as the European average is currently 2%. The primary reason for this shortfall is that government spending on R&D is low, as in 2014 it was only 0.4% of GDP – a quarter of the overall total. The ideal split according to the Barcelona targets of the Lisbon Agenda is that 1/3rd of total R&D spending should be financed by Government. Unless this spending grows at the same rate as nominal GDP, we will move even further away from that target.

Recommendation 15: In order to prevent us moving further away from our targets and to keep Government spending at 0.4% of GDP additional funds will need to be allocated to R&D over the coming years