Note for Oireachtas Committee on Covid 19 Response

Prepared by the ESRI[1], 1 July 2020

We will set out this note with reference to the four issues which we were asked to address in Clerk's letter of 18 June 2020.

1. The effectiveness of programmes targeted at lowering unemployment rates amongst young people in Ireland

Over recent years, researchers at the ESRI have carried out a wide range of work examining the efficacy of active labour market and training programmes, including some targeted at raising rates of employment among younger adults. Notably, McGuinness et al. (2019) find positive effects of the Post Leaving Certificate (PLC) programme on employment and transitions to higher education. However, they also conclude that some PLC courses are poorly connected to the labour market and that reforms could further improve the labour market prospects of participants.

By contrast, Kelly et al. (2019) found no consistent evidence that reforms to Intreo – including the creation of a 'one-stop-shop' – had an impact on exits from the Live Register to employment or education for jobseekers either in Dublin or nationally. Similarly, Kelly et al. (2015) find no evidence that the Back to Education Allowance in operation between 2008 and 2014 improved employment outcomes for recipients, while O'Connell et al. (2012) find evidence that community based employment schemes have little effect in combatting long-term unemployment.

These findings are broadly consistent with those from the international literature, reviewed by Card et al. (2018), which concludes that training and private sector employment subsidies tend to have larger impacts on the long term unemployed, and that programmes tend to be more effective during periods of slow growth.

References

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McGuinness, S., Bergin, A., Kelly, E., McCoy, S., Smyth, E., & Whelan, A. (2019). Evaluating Post Leaving Certificate Provision in Ireland. The Economic and Social Review, 50(3, Autumn), 557-585.

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O'Connell, P. J., McGuinness, S., & Kelly, E. (2012). The transition from short-to long-term unemployment: A statistical profiling model for Ireland. The Economic and Social Review, 43(1, Spring), 135-164.

2. The level and type of financing required by the SME sector to remerge post the Covid restrictions

Assessing the impact on SMEs

The COVID-19 crisis has led to the most rapid and severe economic decline experienced by the Irish economy is modern peacetime history. Estimates of the economic deterioration for 2020 range from 9-17 per cent depending on epidemiological developments.[2] The introduction of required public health measures to stem viral transmission led to the closure of many social and economic activities from March 2020, with many SMEs particularly badly hit. The recent CSO surveys of the business impact of COVID-19 indicate that one-in-four enterprises had ceased trading temporarily (March to mid-May) with one-in-every two firms experiencing a decline in turnover. For nearly 40 per cent of firms, this fall in turnover was over 50 per cent with some sectors such as accommodation and food services, construction and retail particularly badly hit.

How "Crisis Ready" Was the Sector?

While the economic shock has been extreme for Irish SMEs, in many ways, these firms were in a much better place to absorb the shock relative to the situation prior to the financial crisis. Many firms did not have any external debt which meant entering the crisis with low leverage: only two-in-five SMEs report having long term debt[3]. Recent investment activity has also been financed mainly by internal funds[4] and this has ensured firms have not been running up large debt exposures which would create a vulnerability when the crisis hit. However, SMEs have been found to have relatively modest cash holdings at approximately 5 per cent of turnover pre crisis.[5]

Financing Requirements for the Crisis and Recovery

The most pressing question for the SME sector is the degree to which firms have been able to absorb the turnover shock, both in terms of accessing liquidity and deferring expenditure. Estimates from early April from the Central Bank suggest a liquidity shortfall of between €2.4 to €5.7bn over the three months to June. Current work is underway between the ESRI and the Department of Finance to revisit these estimates taking into account new data on turnover and expenditure developments since the onset of the crisis as well as the cash reserves for firms. This will be available in mid-summer 2020.

A number of policies have been introduced in an attempt to provide firms with bridging financing to manage the gap including the Working Capital Loan Scheme or the Restart Grant available from the Strategic Banking Corporation of Ireland and Enterprise Ireland respectively. Take up on these

[2] ESRI Quarterly Economic Commentary Summer 2020, available at: https://www.esri.ie/publications/quarterly-economic-commentary-summer-2020

[3] ESRI/Department of Finance SME Investment Report 2019, forthcoming. Also see Gargan et al. (2018) at https://www.esri.ie/system/files?file=media/file-uploads/2018-09/QEC2018AUT_SA_OToole.pdf

[4] Gargan, Eric, Lawless, Martina, Martinez-Cillero, Maria and Conor, O'Toole,, (2018), Exploring SME investment patterns in Ireland: New survey evidence, *Quarterly Economic Commentary: Special Articles*, issue , number QEC2018AUT_SA_Otoole.

[5] Central Bank of Ireland, Financial Stability Review, 2020:1.

scheme's appears low relative to the number of firms experiencing an economic shock with fewer than 4 per cent of enterprises indicating usage of these programmes.

One lesson from the previous crisis should be heeded at this juncture. If firms are encumbered by excessive leverage, this will slow their recovery as investment and employment growth will likely be lower.[6] Focusing supports on subsidies, grants and other non-debt instruments would help ensure firms have the best opportunity to recover. In this regard, the temporary wage subsidy scheme, which has been accessed by one-in-every-two SMEs is of particular importance. More work will also be required to support trade credit facilities which are particularly high historically in Ireland relative to other countries.[7] An expansion of existing equity financing facilities may also be required. More research is needed to fully scope out the optimal policy response for SMEs as the economy reopens.

3. A note on the potential of funding spending through tax on wealth and the difficulties that are caused when there is low taxation on wealth

Taxes on wealth are typically regarded by economists as attractive as they are relatively less exposed to economic fluctuations and less distortionary than other taxes. The research undertaken by the ESRI and Department of Finance looked at a range of different wealth tax structures using household level data on wealth in Ireland.[8]

The objective of the research was not to recommend or design a specific wealth tax policy but rather to give a broad picture of the different potential designs to inform policy discussion. The approach was to take a wide variety of tax structure designs, varying in terms of qualification thresholds, exemption of specific assets and income considerations. For each possible wealth tax structure, we examined how these affected the share of households that would be liable for the tax, the average payment, total tax yield and distribution of the tax liability across households.

The first set of scenarios were based on examples of wealth tax structures in existence in other European countries matched to Irish household wealth data. A second set of scenarios were more stylised to highlight the threshold and asset composition effects on the size of the tax base and potential yield. These hypothetical tax designs start from broadest possible tax base and a low threshold, thereby casting a wide tax net, and then examine the impact of applying exemptions to specific assets (especially the household's main residence) and increasing the qualifying threshold.

Varying the level of the threshold is the key determinant of the number of households that will be affected, which is in keeping with the concentration of wealth at the upper end of the wealth distribution. The wealthiest 10% of households at the time of the survey in 2013 held close to 54% of total household wealth.

The treatment of the household's main residence (which is the largest asset for almost all households apart from the very wealthiest) is an important factor in the level of average tax payment and hence total revenues raised.

The final critical determinant of potential revenue yields is of course the rate applied. All of our results were based on the same assumption of having a 1% rate applied to all qualifying wealth

[6] See Lawless, Martina, Brian, O'Connell, and Conor, O'Toole,, (2015), SME recovery following a financial crisis: Does debt overhang matter?, *Journal of Financial Stability*, **19**, issue C, p. 45-59.
[7] O'Toole, Conor, Lawless, Martina and Lambert, Derek, (2015), Non-Bank Financing in Ireland: A Comparative Perspective, *The Economic and Social Review*, **46**, issue 1, p. 133-161.
[8] Martina Lawless and Donal Lynch, "Scenarios and Distributional Implications of a Household Wealth Tax in Ireland", IFO DICE Report 2 / 2018 June Volume 16

above the specified threshold. However, as this is a simple proportional rate, the revenue from alternative rates would be a multiple of the number reported – a 0.5% rate would half our revenue estimates or a 2% rate would double them for example. The effects of introducing multiple rates would be more complex but their upper and lower bounds can be set by these single proportional rate estimates.

Although we find that the bulk of the tax revenues would be raised from higher income households under all tax designs, some households at all points in the income distribution would find they are liable for some payment in all but the most narrow tax base case.

In almost all cases the percentage of wealth tax revenue raised from households with a reference person aged 65 or more is well in excess of their share of the population. This comes from these households being most likely to own a property without any offsetting mortgage liability.

Applying an income restriction would remove many of the lower decile households from the tax net in most cases but would also reduce the numbers liable in the higher income deciles as well. We also find that the beneficiaries of an income cap are likely to be those in the highest wealth deciles.

A number of limitations of the research and other considerations are worth noting:

The household survey data used relates to 2013 and the monetary values are therefore rather outdated. However, the points on the broad patterns relating to the effects of decisions on the tax threshold and exemptions on the share of households liable, yields and distributional effects remain valid despite the overall growth in asset values over time.

As the data used in the research was drawn from a household survey, there is the possibility that the most wealthy households are under-represented.

No behavioural change in asset ownership in response to a change in taxation is incorporated.

In the research, all wealth is assumed to be owned jointly by the household and taxed at a household level. In practice, taxing household wealth has been found to be administratively complex and the ownership of assets and identification of the appropriate tax unit is one element of this. Further complexity arises in regard to the valuation of assets and the frequency with which these would need to be reassessed.

The research notes that coverage and yield are heavily influenced by whether the household's main residence is included or exempted from the tax. In this context, it is worth noting that all of the wealth tax structures examined differ from the local property tax by offsetting any debts that the household may have including mortgages.

4. A note on potential reduction in the carbon emission arising from a carbon tax increase of €10 per tonne

At the Oireachtas Committee meeting on 16 June, Deputy David Cullinane referenced a Quarterly Economic Commentary Special Article from 2019, by Miguel Tovar Reaños and Muireann Lynch. The numbers presented in the article in question are that an increase of €30 in carbon taxation, from €20 per tonne to €50 per tonne, would lead to a reduction in carbon emissions of 3.9%. Deputy Cullinan indicated in his question that the authors had analysed the effect of a carbon tax increase from €20 to €30 rather than the increase from €20 to €50.

The authors also simulated the impact of an €80 increase, to €100 per tonne, and found this would lead to a reduction in carbon emissions of 10.2%. These results were established by examining

historical expenditure by Irish households, collected by the CSO as part of the Household Budget Survey, as well as historical prices, and by estimating the statistical relationship between energy prices and expenditure.

The authors would be happy to answer any queries on this research.