Irish Fiscal Advisory Council

Opinion piece: Save excess corporation tax revenues now to limit future tax rises needed to pay for pensions

Although Ireland benefits from corporation tax revenues and high-paid jobs in the multinational sector, we have become overreliant in recent years. The risk from a sudden loss of corporation tax receipts is clear. However, even if this tax boom were to continue for several years, it raises difficult questions. Saving a part of corporation tax revenues in a new National Pension Reserve Fund would help to limit future rises in taxes to pay for pensions.

Favourable trends in the digital, pharmaceutical and financial sectors and changes in the international tax environment have brought more multinational activities to Ireland. This has led to a sharp increase in corporation tax revenues and created many increasingly well-paid jobs. Corporation tax receipts last year accounted for one-in-five euros of Exchequer revenue. Payments by multinationals alone account for around 5% of national income, almost twice as much as the total amount in most European countries and well above its historical level here.

The Fiscal Council estimates that €6 to €9 billion of corporation tax receipts are in "excess" of what can be explained by the underlying performance of the domestic economy since 2015. Half of the total receipts are paid by 10 companies. Recent research by the Council shows how the growth of high-pay, high-tax jobs has boosted income tax receipts.

There is a clear risk that changes in the performance or tax planning of a few companies could lead to a significant hole in the public finances.
However, there is another scenario where corporation tax receipts could remain high or even increase for some time in the years ahead, even if it is likely that — at some point — this will end. This raises questions about what the best use of a boom in tax revenues is and how to ensure these inflows do not destabilise the economy.

Government and household spending backed by the inflow of money from the exports of multinationals located in Ireland will tend to make the economy run hot. This adds to high prices, particularly for land and housing. With this tax boom expected to run its course at some point, it would be unwise to become dependent on this money to fund on-going permanent spending .

Should we enjoy these resources now or would be it better to save them for more challenging times ahead?

Ireland's population is ageing rapidly. People are living longer, with life expectancy at age 65 increasing by just under a year for every five years. At the same time, there will be around 75,000 people reaching retirement each year in the 2040s, 50 percent more than today.

The Pensions Commission last October concluded it would be a "strategic risk not to take steps to shore up the fiscal sustainability of the State Pension". The preferred option combined raising the retirement age and increasing PRSI contributions. The Government has yet to respond.

Under this option, PRSI contributions by employers and employees would rise substantially: the increase in tax on a worker earning a typical wage of €35,000 would be at least €1,000 a year. This reflects the challenge of running a pay-as-you-go pension system when some generations are larger than others. These increases would be far higher under options that allow the length of retirement to expand. The costs of providing pensions will be at its highest when there are the fewest working-age people to contribute.

An alternative approach is to save part of the “excess”corporation tax receipts now in a new National Pension Reserve Fund. This could be used to reduce the scale of tax increases required to sustain the pension system.

The Fiscal Council has advised, at minimum, to cap the reliance on corporation tax receipts at the current level. Preferably, the reliance would gradually be reduced over time. The funds that are saved could be used to contribute to the Rainy Day Fund or to pay down debt.

This would not be an alternative to making changes to improve the sustainability of the pension system: higher taxes and raising the pension age gradually would still be needed. However, it could provide some scope to avoid having to raise taxes so much and would strengthen the effort to tackle the future rise in pensions costs now. How much it could contribute to financing future pensions is highly uncertain, but the amounts could be substantial. If all “excess” corporation tax receipts since 2015 had been saved in this way, contributions of €22 billion would have accumulated.

Ireland in the past had a National Pension Reseserve Fund set up in 2001 that aimed to help mitigate rising pensions costs. While this was ultimately diverted to helping manage the banking crisis and not been reinstated, it did show how such funds can build up and earn a significant return. Norway has faced similar challenges in managing export revenues from the oil industry. The Norwegian Government Pension Fund has helped to manage the economic impact of oil exports and has built up the world’s largest sovereign wealth fund. While the scale is different, there is much Ireland could learn from this approach.

Ireland’s success in attracting multinational activities is of great benefit in terms of jobs and tax revenues. Looking ahead, we need to prepare for the fact that the current boom of revenues may not last forever. Sound management suggests saving these revenues to address future challenges like ageing. Transferring excess corporation tax revenues to a new National Pension Reserve Fund could help solve the pensions conundrum and reduce the need for any future tax increases.

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