Institute for the Study of Social Change

ISSC DISCUSSION PAPER SERIES

PAYING FOR GOVERNMENT

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Published in:
Dissecting Irish Government: Essays in Honour of Brian Farrell,
edited by Tom Garvin, Maurice Manning, Richard Sinnott.
Dublin, UCD Press, 2004.

This paper is produced as part of the Governance Research Programme at ISSC; however the views expressed here do not necessarily reflect those of ISSC. All errors and omissions remain those of the author.

ISSC WP 2004/11

INTRODUCTION

Paying for Government

‘Governments need money. Modern governments need lots of money. How they get this money and whom they take it from are two of the most difficult political issues faced in any modern political economy’ (Steinmo, 1993: 1).

Without taxation, there can be no government. Every society needs tax revenues to provide salaries for politicians and civil servants. They need taxes to pay for teachers, medical staff, and police. Taxes are needed to pay for roads, water supply, and waste disposal. Without tax revenues governments could not act effectively to alleviate poverty, help people through hard times such as unemployment and illness, or support people in their old age. In short, the whole range of government functions, which we mainly take for granted, or which only come to prominence when their shortcomings are being criticized, would not be possible without an adequate, steady, and reliable supply of revenue. As the American political scientist Theda Skocpol has noted, the tax base of government can shape and constrain its spending plans in important ways: ‘A state’s means of raising and deploying financial resources tells us more than could any other single factor about its… capacities to create or strengthen state organizations, to employ personnel, to co-opt political support, to subsidize economic enterprise, and to fund social programmes’ (Skocpol, 1985: 17).

The manner in which states raise these resources – who pays, how much they pay, and indeed who does not pay – is an issue of central political importance. Differences in the priorities adopted by successive governments may be less important than the continuities. One of the paradoxical features of taxation is that a good tax is generally held to be simple, easy to administer, fair – and largely invisible (Guy Peters, 1993: ch.1).

Taxes usually make headlines when people feel they have been unfairly treated, as for example in the employee protest marches on the streets of Irish towns and cities in 1979 and 1980; or when they feel that other people have been allowed to bend the rules, as in the case of Ansbacher accounts and other tax-evasion schemes. But any combination of taxes implemented by government is politically significant, because every tax, or tax exemption, entails a judgement about how costs and benefits are going to be distributed.

Discussion of tax policy tends to be dominated by economists; it tends to focus on more technical aspects of tax design, or on the effects of taxes on market incentives, or on the distribution of income before and after taxes and transfers. There are many aspects of tax policy making and implementation to which political scientists can usefully contribute their complementary perspective. It would be entirely consistent with Brian Farrell's longstanding and keen engagement with the evolution of public policy – both in the academic domain, and in his role as challenging television journalist – to seek to open up some of these issues for further analysis and research.

THE EVOLUTION OF THE TAX SYSTEM IN THREE SNAPSHOTS

States raise their revenues in rather different ways. There is no consensus on what constitutes the best or optimal way of raising taxes. We may see how the profile of Irish revenues has changed over recent decades, relative to an aggregated profile of other countries' experiences, by taking three snapshot views. The dates chosen here are 1965, 1985, and 2000. We will look at how the profile of the tax system changed between these three points in time, by looking in turn at trends in total taxation, the composition of taxes, and the changing significance of income tax.

Total Taxation

The first of our three dates, 1965, captures the situation as Ireland was entering a new phase of economic development, with the turn toward export-led growth and greater trade openness. Total Irish tax revenues at this point were somewhat below the European average, though well above the levels typical of the southern European countries that were comparable to Ireland in terms of economic development, and about comparable with the level of taxes raised by the USA.

Table 1. Total taxation as a proportion of GDP

	1965	1985	2000
Ireland	24.9	35.0	31.1
OECD average	25.8	33.9	37.4
EU 15	27.9	38.8	41.6

Source: OECD *Revenue Statistics 1965-2001* (2002). Table 3, pp. 73-4.

The second snapshot portrays the revenue system at a time when tax revenue as a proportion of GDP had reached a peak. The mid-1980s were a time of great economic and social difficulties, when governments were struggling to manage economic recession while also deal with huge repayments on the public debt. Unemployment was rife, and emigration was running high. Total taxes at this point exceeded the OECD average; most people, especially single employees, believed they were severely over-taxed, and that income tax in particular represented a crippling burden on their incomes. In return for these taxes they saw – not an expansion of public services, in line with more highly taxed countries elsewhere in Europe – but restrictions and even retrenchments in public expenditure.

By the time of our third snapshot in 2000, Ireland had had several years of the most rapid and sustained growth it had ever experienced. Many more people were at work, and unemployment was at record low levels. Tax revenues were very buoyant, a situation that was to continue until 2001. A decade of tax reform meant that most employees were now more lightly taxed. Even though taxes had been cut, rapid economic growth nonetheless resulted in increasing tax revenues. Yet GDP was growing even more rapidly, so tax expressed as a proportion of GDP shows a marked drop in spite of the growing tax intake.

The Composition of Taxes

Over time, not only can we see changes in the overall level of taxies levied, we can also see big changes in the composition of taxation. As Table 2 shows, between 1965 and 2000, taxes on goods and services (such as VAT, customs and excise duties and so on) declined from providing over half to about two-fifths of total revenues. This is in line with trends in a number of other countries; a widespread move to more diversified sources of taxation can be discerned.

Table 2. The composition of Irish taxes as a proportion of total taxation

	1965	1985	2000
personal income tax	16.7	31.3	30.1
corporate tax	9.1	3.2	12.1
employee social security	3.2	5.2	3.9
employer social security	3.3	9.4	8.1
property	15.1	4.0	5.5
goods and services	52.6	44.4	38.4
total tax revenue, €m	317	8,586	32,153
GDP, €bn.	1.3	24.5	103.5
tax as per cent of GDP	24.9	35.0	31.1

Source: OECD *Revenue Statistics 1965-2001* (2002), various tables.

The significance of corporation tax has varied. Recession during the1980s depressed its significance as a revenue source. By 2000, strong growth yielded higher and rising revenues from this source. Social security contributions, on both employers and employees, show a somewhat different pattern. Having risen until the mid-1980s, their contribution to overall revenues had fallen back by 2000.

The most striking trend, though, is the doubling in the significance of income tax between 1965 (that is, just five years after the adoption of the Pay-As-You-Earn or PAYE system of income taxation) and 1985. Between 1985 and 1999, despite the cuts in tax rates, income tax retained its importance as a source of taxation. Moreover, while income tax had been a good deal less important in Ireland than elsewhere in the OECD area in the 1960s, this situation had changed by 1985. And once again, despite the tax reforms, especially in employee income tax, during the 1990s, income tax was still relied on more heavily in Ireland than was typical elsewhere (though we must allow for the fact that there are considerable variations in the patterns in evidence across a range of countries – see Hardiman, 2002a).

Table 3. Income tax as a proportion of total taxation

	1965	1985	2000
Ireland	16.7	31.3	30.8
OECD average	26.1	29.7	26.0
EU 15	23.9	28.0	25.6

Source: OECD *Revenue Statistics 1965-2001* (2002), Table 11, p.78

The Distribution of Income Tax

What is striking about the changing profile of taxation is not only that income tax came to be so much more important as a revenue source; it is also that the distribution of the burden has varied considerably over time. This is the main reason why it became a highly contentious issue during the 1970s and 1980s. Table 4 shows that single people earning the average industrial wage paid about 15 per cent of their earnings in tax and social insurance in 1965, and married people just over four per cent. Single people on somewhat higher earnings – double the average industrial wage came close to the pay of middle-ranking civil servants or middle managers in private enterprise – were paying a little higher, at just over 19 per cent, and married people about 14 per cent. People on very low earnings, half average industrial earnings, were not in the tax net at all at this point, and were liable only to social insurance contributions on their earnings.

Table 4. Income tax and employee social security contributions as a proportion of direct earnings in Ireland in 1965, 1985, and 2000, for three income levels and two family types

	1965	1985	2000
½ average industrial earnings, single	5.6	22.1	7.5
½ average industrial earnings, married + 2	5.6	8.5	-
average industrial earnings, single	15.0	34.5	20.4
average industrial earnings, married + 2	4.3	25.1	14.0
2X average industrial earnings, single	18.6	49.4	34.4
2X average industrial earnings, married + 2	14.0	35.8	24.4

Source: Source: Author's own calculations. Earnings data are taken from *Statistical Abstracts* and *Statistical Bulletins*, Central Statistics Office, various years. Tax rates are calculated from Revenue Commissioners' Annual Reports, various years. Social Insurance liabilities are calculated from Department of Social Welfare Annual Reports, various years and Budget Books, various years. 'Married + 2' refers to a single-income married couple with two children. Tax treatment of married couples changed from the early 1980s; and the move to tax individualisation of two-earner married couples changed again from 2001; but these considerations do not affect the calculations shown here. Only statutory allowances are taken into account. See Hardiman (2002a).

By the mid 1980s, this situation had changed greatly. People earning the average industrial wage were now paying over one-third of their earnings in tax and social insurance if single, a quarter if married. Those on twice the average industrial earnings were paying over one-third if married, and just about half their earnings if single. Those on very low incomes now found themselves inside the tax net and liable to pay over one-fifth of their earnings in tax and social insurance if single, and almost 8 per cent if married. Between income tax and social insurance, revenue liability had at least doubled for most, and for some categories had grown fourfold.

What was even more striking was the growth in marginal tax rates. Table 5 shows that all categories of employees faced significantly higher tax and social insurance charges on each additional pound of earned income between 1965 and 1985.

Table 5. Marginal rate of combined tax and social insurance for three income levels and two family types, 1965, 1985, 2000.

	1965	1985	2000
½ average industrial earnings, single	-	43.5	22
½ average industrial earnings, married + 2	-	8.5	-
average industrial earnings, single	31.7	56.3	28.5
average industrial earnings, married + 2	31.7	43.5	28.5
2X average industrial earnings, single	31.7	62	46
2X average industrial earnings, married + 2	31.7	50	46

Source: As for Table 4.

By 2000, however, we see that all income categories were being taxed much more lightly. Single people on very low incomes still found themselves in the tax net, and most of the improvements in their situation – until after 2000 at any rate – had come through reductions in social insurance liability; but married people at this income level were now completely outside the tax net. Single employees on average and on twice-average industrial earnings had seen something like a fifteen-point drop in their liability, and married people a drop of a little over ten points.

UNDERSTANDING TAX CHANGES

What accounts for these dramatic shifts in the profile of the Irish tax system, firstly between the mid-1960s and the mid-1980s, and secondly between the mid-1980s and the present day? We might think of our explanation as featuring three different elements. None of them works entirely separately, so the distinction can be somewhat artificial. But attempting to distinguish between them might nevertheless help to illuminate why things happened as they did.

The first element might be thought of as the inheritance of policy provisions which every government encounters when it assumes office. The revenue system needs stability and can be difficult to change quickly; moreover, governments are generally reluctant to modify taxes that are seen as reliable and that yield a good flow of income. This element of the explanation might be thought of as the 'inertia' of the system – more of the same (cf. Rose and Karan, 1987). For long periods there might be very little demand in a society for changes to the tax system, as long as most people think it is both efficient and fair. But even in the face of taxpayer discontent, governments may be unwilling to consider fundamental changes to any tax that has proven to be a reliable and sizeable source of revenue.

The second element, in contrast, might be thought of as featuring innovation, that is, deliberate decisions taken by government to introduce initiatives that alter the existing profile of the tax system. This might mean introducing new taxes, or it might mean a decision to change the effects of existing taxes. This would have to amount to something more than the year-on-year marginal adjustments of tax bands and allowances that are a normal part of the inertia of the tax system. There might be good reasons to expect that different political parties might evince different priorities, on issues such as who pays, and how much they pay, in the innovative decisions they take. But from time to time we may also expect to see a sea-change in the fundamental principles that governments believe should underpin their tax strategy. As we shall see, a wave of new thinking about taxation spread widely and rapidly across the countries of the developed world during the latter half of the 1980s and into the 1990s, and Ireland was no exception.

The third element concerns the wider circumstances in which governments make decisions about continuing with existing tax instruments or changing the thrust of tax policy. Governments are of course sovereign when it comes to making tax policy. But they do not make it in circumstances of their own choosing, or not entirely at any rate. The economic environment in which the tax system is embedded may constrain governments' freedom of choice at some times, or permit greater freedom of manoeuvre at others. A set of tax measures might work quite well for a time. When economic circumstances change, continuing to run tax policy the same way may produce perverse incentives. In a buoyant economic environment, government may have more scope for initiative and innovation than in the middle of a recession. And finally, of course, membership of the EU may shape government's options and preferences in distinctive ways.

We have three elements of explanation to draw on so: inertia, innovation, and economic environment. We now turn to explore the relative importance of each over the two time-spans in which we are interested.

PHASE ONE: THE RISE AND RISE OF INCOME TAX

The story of the tax system in our first time-frame – from the mid-1960s to the mid-1980s – is largely one of 'taxation by inertia', compounded by a narrowing in governments' options in the worsening economic environment that set in towards the end of the period, during the 1980s.

Taxation by Inertia

At the start of the period in which we are interested, the Irish welfare state was not well developed by European standards, and spending on income maintenance and social services lagged developments in most continental countries. During the 1960s and 1970s, new spending commitments meant that Irish governments developed a growing need for steady revenue flows. We see some government interest in tapping new sources of revenue; this diversification may be thought of as a modernizing trend in tax policy. For example, during the 1960s, Fianna Fáil governments introduced new forms of indirect taxation, which were consolidated in 1972 into the Value Added Tax.

But we have also noted that governments increased their dependence on income tax relative to other tax sources, as it was reliable, relatively easy to administer, and yielded a good revenue flow. As Gladstone once famously remarked, income tax provides government with 'a colossal engine of finance' (in 1853; cited in Réamonn, 1981: 37).

What is remarkable about this phase is how narrowly based the tax system remained, notwithstanding the need for a greater revenue yield. The story of who did not pay is just as interesting as the story of who did. In some cases, a relatively light tax burden was a matter of policy. From the 1950s, Ireland had been committed to tax-based incentives for industrial investment, initially targeted at exporting companies, then extended to all manufacturing industry. Low corporation tax rates were recognized as providing the foundation for the increased inflow of American and other foreign investments, especially once Ireland joined the European Economic Community (as it then was) in 1973.

But apart from the deliberate policy decisions to implement some preferential corporation tax rates, the distribution of the tax burden became increasingly skewed during the time-period we are looking at here. Self-employed people who were not inside the Pay-As-You-Earn net encountered relatively few efficient tax-gathering mechanisms. Farm income was not targeted effectively. And while farmers' earnings were still quite low during the 1960s, Ireland's accession to the EEC brought improvements for many. Income from self-employment and income from property were similarly subject to a fairly lax regime of self-assessment, and weak monitoring by the tax authorities made full compliance less than mandatory.

In these circumstances, governments depended ever more heavily on the 'colossal engine' of direct income tax, and indeed they relied increasingly on 'fiscal drag' to raise revenues from this source. Inflation started to become more pronounced from the late 1960s – well before the oil-price crisis that drove inflation spiralling upwards after 1973 – but governments failed to index allowances or to adjust tax bands accordingly. The result was that more and more people were drawn into the tax net – and found that more and more of their income was subject to tax and social insurance contributions. Between 1960 and 1975, while the numbers at work had grown by about 55,300, the number of individual tax-payers had expanded by more than ten times that number, from 220,000 to 740,000 (Byrne, 1989: 42). Indirect taxation was also perceived as inequitably distributed, adding to the grievances of many employees. With essentials such as food and clothing liable to VAT, the Household Budget Survey of 1980 reported that lower income households paid some 21 per cent of their incomes on indirect taxes, compared with 14 per cent among higher income households. Ireland is not the only country to have experienced tax revolt in such circumstances. Massive public discontent spilled out into street demonstrations; something had to be done.

Thwarted Initiatives

Governments faced real political difficulties in any attempt to remedy the skewed tax system – any extension of the tax base was likely to encounter resistance from the groups affected. Significant initiatives had to await the advent to power of a Coalition government of Fine Gael and Labour (1973-77). In an attempt to broaden the tax base, Fine Gael Minister for Finance Richie Ryan introduced three new taxes on different types of resources – a Capital Gains Tax, a Capital Acquisitions Tax, and a Wealth Tax. Sandford and Morrissey (1985) document the extraordinary lobbying and opposition encountered by the government over these taxes. Quite independently of the merits of these taxes, the relatively privileged groups who would be affected by them mounted a sustained campaign of opposition. Fianna Fáil won power in 1977 amid promises not only to abolish the Wealth Tax, but also to remove other targeted sources of revenue, particularly domestic property rates and car tax, thereby throwing an even greater burden on the central Exchequer and its existing revenue base. Electorally, this proved a winner. From the point of view of broadening and diversifying the tax base, it was a backward step.

Taxing farm incomes proved equally politically difficult. Fianna Fáil attempted to introduce a resource tax in 1979, but met with vociferous resistance from farmers, to which government acceded. The farmers' capacity to resist further encroachment by the tax authorities was strengthened by a Supreme Court decision in 1982 which deemed agricultural rates, hitherto the principal kind of tax paid by farmers, to be unconstitutional in virtue of their design and implementation (O'Connor, 1993).

During the latter half of the 1970s, both the Coalition and the Fianna Fáil governments made a number of adjustments to the tax rates and tax bands applying to employees. But they could not forestall the tax protests of the end of the decade. A Commission on Taxation was set up in 1980, and produced a series of reports over the following years, including a number of acute analyses of the shortcomings of the existing system. Its recommendations for reform were radical: it proposed that the existing income tax system should be scrapped in favour of a much lower tax on income at source, combined with a greater reliance on expenditure taxes. This anticipated some aspects of the tax reform movement that gained currency later in the 1980s, in prioritising a comprehensive definition of income, implying a broad tax base with few exemptions, low basic rates, and transparent application.

Crisis in the Economic Environment

The reports of the Commission on Taxation reports played only a very slight political role in shaping tax policy, although they increasingly worked their way into the broader debate about tax reform through commentary by expert analysts (see, for example, O'Toole, 1996). Two of our three explanatory factors may be drawn upon to explain why this was so.

The first is the economic environment. Just when discontent with the tax system reached a crescendo, governments were beginning to acknowledge the enormity of the fiscal problem they faced. The Fianna Fáil fiscal boost of the late 1970s had resulted in high and rising borrowing requirements – but international recession after 1979 made subsequent correction difficult. Public spending was still surging ahead. Servicing the public debt alone consumed a growing share of revenues. Debt service charges amounted to about two-thirds of the revenues generated by income tax in 1977, but 94 per cent in 1985 (Budget Books, various years). Government instability in the early 1980s also made a consistent tax stance very difficult to adopt. Once the Fine Gael-Labour government of 1983-87 established itself, the severity of the recession made deep cuts undesirable. Tax-based fiscal adjustment seemed the most prudent strategy (Honohan, 1999).

This sets the scene for our second explanatory variable, the reliance on the force of taxation by inertia. Existing revenue instruments had proved their worth; the middle of a recession was no time for innovation. Therefore, bad and all as the tax burden had seemed to employees in 1980, it became even more onerous by 1985.

These factors help us understand the seeming paradoxes of Irish tax policy at this time. A country in which nearly one in five workers was unemployed was adding to the 'tax wedge' each year, that is, the gap between total employer payroll costs and employee take-home pay, thus further reducing the incentives to create jobs. A country in which about two-thirds of the unemployed were classed as long-term unemployed made it additionally difficult for many of these to escape welfare dependency because of the tax and social insurance liabilities they faced once they took paid work.

PHASE TWO: TAX REFORM AND ITS LIMITS

In contrast with the first phase in the development of the tax system, the second phase, from the mid-1980s to the present, displays a considerably greater measure of innovation. But the economic environment also proved crucial to the scope afforded to governments to engage in new directions in tax policy.

The Innovations of Tax Reform

There was no major departure from the lineaments of the existing system during our second phase, from the mid-1980s to the present, notwithstanding the recommendations of the Commission on Taxation. But the stance of governments changed. It would appear that the main political parties in Ireland all became committed to the principal tenets of the international tax reform movement. These ideas were widely disseminated by the OECD. They accorded priority to improving supply-side policy through broad-based taxation with fewer exemptions, fewer and simpler tax bands, and lower tax rates. Tax shelters were to be dismantled, and similar tax rates to apply to income from diverse sources, to provide a 'level playing field' for all economic actors. Tax policy was no longer seen as an appropriate means of shaping people's economic behaviour, or indeed of altering distributive outcomes (see, for example, Steinmo, 1994: 160).

The essential features of this new approach run through the policies adopted by all the governments that have held power since 1987. The demonstration effect of Britain's early and radical adoption of these principles was undoubtedly an important influence. In 1983/84, employee income tax in Ireland was structured into five rates, ranging from a low rate of 25 per cent and a standard rate of 35 per cent to the highest rate of 65 per cent. By 2002 there were only two rates, set at 20 per cent and 42 per cent. Tax expenditures and write-offs had been severely curtailed, and most remaining allowances could only be availed of at the standard rate. The tax base had thereby been broadened and the structure of the tax system had been flattened out. The principle of progressive taxation had given way to the primacy of efficiency. This represents what we might think of as a 'Gestalt shift' in tax principles – a far-reaching change in the basic assumptions according to which the efficiency, effectiveness, and equity of taxes are evaluated.

Complementing this shift in the visible face of tax, especially income tax, was a major reform in tax administration. The tax amnesty of 1988 signalled a move toward a more effective tax gathering system. This opened what was widely expected to be a once-only window to those in the black economy, or whose tax affairs were not in order, after which the full rigours of prosecution were promised. Reforms to the self-reporting system for self-employed workers and for farmers increased the incentives for voluntary compliance, while the sanctions to the Revenue Commissioners were strengthened (Cassells and Thornhill, 1993). These reforms to tax administration were an integral part of the tax reform movement that characterized the 1990s.

This is not to deny the pivotal role of key individuals at various moments in this process. For example, the role of Fianna Fáil Finance Minister Ray MacSharry was certainly important in setting the minority government of 1987-89 firmly on the track of implementing both tax cuts and spending cuts. So too was the role of Fine Gael leader Alan Dukes in the 'Tallaght strategy' of providing parliamentary support for these measures. A little later, Sandford (1994) identifies a distinctive contribution by the Progressive Democrats to the market-oriented priorities adopted by the coalition government which they formed with Fianna Fáil between 1989 and 1992.

Nor is it to overlook the possibility of differences in emphasis between parties, within the broadly accepted shift to a tax reform strategy. For example, the governments in which the Labour Party participated (with Fianna Fáil between 1992 and 1994, and with Fine Gael and Democratic Left between 1994 and 1997) displayed a somewhat greater interest in orienting the distributive outcomes of tax cuts toward the lower paid, by placing greater emphasis on widening allowances and bands rather than cutting tax rates (Hardiman, 2000).

Yet differences in distributive emphases are also very much in evidence within a single administration. The Fianna Fáil-Progressive Democrat government of 1997-2002 swung between measures favouring the wealthy, such as cutting top rates and halving the Capital Gains Tax rate, and measures favouring the less well off, such as widening bands and increasing tax-free allowances, and raising the eligibility threshold for social insurance payments. On the whole, the tax measures of the latter half of the 1990s were more favourable to wealthier people (cf. Hardiman, 2002a). To some extent this is an inevitable corollary of the move away from progressive taxation towards fewer and lower rates. But a number of initiatives sought to change the thrust of the tax system in important new ways that did not lend themselves to easy summary in terms of conventional partisan politics.

For example, this government introduced two major initiatives with divergent distributive consequences for households. In Budget 1999 (December 1998), tax-free allowances began to be replaced by a system of tax credits, which were most beneficial to those paying tax at the standard rather than the higher rate. In Budget

2000 (December 1999) the basis on which married couples' tax liability was calculated was altered. Since a Supreme Court decision in 1979, they had been accorded two full allowances, to be shared as they pleased, implicitly favouring single-earner married couples and supporting the home-making role of the non-earner. Now the signal was given that the system would move, over a period of time, to fully individualised tax allowances. This was defended on grounds of efficiency, as it increased the incentives to spouses to take paid work at a time of labour shortages. Moreover, while moving away from progressivity in total household taxation, it represented an increase in distributive equity for individuals (see Callan et al, 2001: ch.5).

By the early 2000s, therefore, we can see that a major change had been wrought in the thrust of tax policy and in the design of the tax system. Within the framework of existing tax instruments, significant innovation had occurred on a number of fronts.

The Determinants of Innovation

Changes in the effects of some taxes were driven by debates taking place at EU level, for example, in the case of VAT (O'Toole, 1996). The most striking of these is undoubtedly the case of corporation tax. Ireland's preferential rate of 10 per cent for manufacturing later was extended to internationally traded financial services and to areas such as computer software. These provisions came under growing EU scrutiny in the late 1990s. Irish government representatives strongly resisted proposals for EU-wide tax harmonization, as the capacity to control corporation tax incentives was perceived as central to the country's successes in attracting foreign direct investment.

Intensive lobbying secured agreement that all Irish corporation tax rates could converge upon a single low rate, set at 12.5 per cent, by 2003 (although firms in the international financial services sector would continue to benefit from the 10 per cent rate until 2005, and some manufacturing firms until 2010). The standard Irish corporation tax rate for most firms had been set at 50 per cent for most of the 1980s; this was brought down progressively and stood at 24 per cent by 2000. This already placed Ireland second in an international survey of tax competitiveness undertaken in that year (Forfás, 2001, Table 7, col. 10). The extension of an even lower and uniform rate to all firms can only be explained by the EU context.

However, other changes in tax policy cannot be so easily explained. The overall design of tax reform does not display the coherence of an overarching vision. Alongside the tax reform priorities of base-broadening, a range of new allowances and tax incentives was allowed to develop; while each was defended with reference to its desirable social purposes, the trend nevertheless ran counter to the central tenets of the tax reform movement.

Where major innovations have occurred, they have relied on the energy and vision of particular individuals to drive them through. They have not, in the main, entailed much of a consultative process – notwithstanding the well-established consultative mechanisms that have developed out of social partnership processes (cf. O'Donnell, 20001). In this, tax policy making in Ireland is more like that of Britain than that of, for example, Sweden (cf. Steinmo, 1993).

The two major income tax initiatives of the late 1990s – the move to tax credits, and the move toward individualisation of tax assessment of married people – illuminate both the strengths and the weaknesses of tax policy-making processes in Ireland. Radical choices could be made and implemented fairly quickly by strongminded Ministers (in this case, Fianna Fáil Finance Minister Charlie McCreevy). On the other hand, the consultative process was so limited that the interests and concerns of many affected groups were not taken into account.

For example, cuts in personal income taxes were central to the pay-tax deals negotiated by the main social partners during the 1990s (Hardiman, 2002b). The Minister acknowledged no obligation to respond to the tax priorities identified through the National Economic and Social Council (NESC), the consultative social partnership body, whether in the adjustment of allowances and bands, or in the far more radical shift to tax credits. Similarly, the move toward individualisation disappointed the many lobbyists, inside as well as outside the social partnership structures, who had hoped for more systematic fiscal supports for families, particularly those with child-rearing responsibilities. The Minister's innovations cut through potentially crippling political opposition. But the extent of the opposition could nevertheless prove politically embarrassing at times. Widespread criticism greeted the Minister's announcement of individualisation, notwithstanding the complementary increases in direct family support through increases in child benefit. His response was to hastily introduce a new non-employed spouse allowance. This was an example of what NESC has described as a 'proliferation of new tax reliefs without any obvious guiding principle', which it called 'a cause for concern' (NESC, 1999: 202).

Constraints on Innovation: the Power of Vested Interests

Tax innovation has not been firmly and consistently grounded in a clearly articulated set of widely shared principles. It would be a mistake to believe that tax reform priorities extended quickly to all areas of policy making or indeed of tax administration. This opens the question as to how governments' priorities have in fact been shaped.

Some privileged groups continued to be able to pay disproportionately low levels of tax, finding means of sheltering much of their income in quite legitimate ways. Early in 1998, for example, the Department of Finance released a summary of the findings of the Revenue Commissioners concerning the income tax paid by very high earners. This stated that in 1994/95, 8.5 per cent of those earning over a quarter of a million pounds had paid no income tax at all, and a further one-fifth paid at an effective rate of less than 25 per cent.

Privileged groups were clearly adept at protecting their interests, often through direct influence over the policy process. In one notable instance, that of Residential Property Tax (1983-1997), open opposition caused governments to change their mind. This tax was originally intended not only to generate extra revenues but also to widen the tax base at a time when it was well known that incomes were already too heavily taxed. Kevin Rafter concluded that the whole experience 'indicated a responsiveness to middle class voters to the detriment of the wider community' (Rafter, 2000: 63).

But less overt lobbying, while harder to trace, may be even more successful in shaping government decisions. Former Finance Minister Ray MacSharry noted that the lobbying power of vested interests was 'a threat which every tax reforming

Minister for Finance has to deal with', and that 'lobbies operate much more effectively in secret' (MacSharry, 1994).

A number of decisions on tax policy remain unexplained, among them the reasons for the extraordinary second tax amnesty of May 1993. The Fianna Fáil-Labour government was deeply divided about it – and while it was perceived as the brainchild of Taoiseach Albert Reynolds, Fianna Fáil Minister for Finance Bertie Ahern is reported to have opposed it vehemently until the day of the Cabinet meeting (see Finlay, 1998).

This was signalled as the very last opportunity for tax evaders to become fully tax compliant before the full rigours of the law finally fell upon them. Yet it became clear throughout the 1990s that numerous schemes facilitating tax evasion continued to thrive – and numbered among their beneficiaries former Taoiseach Charles J. Haughey (Keena, 2001). Other schemes included collusion between banks and their customers to evade tax on deposit interest, and ingenious arrangements such as the Ansbacher offshore bank accounts. These were the subjects of only two of a number of official investigations in the early 2000s. It was not until the Finance Act of 1999 that the Revenue Commissioners finally got the legal powers, and began to acquire the personnel resources, that they claimed they needed in order to do their job properly (see 'Revenue Powers and Penalties', Department of Finance Tax Strategy Group, report 01/09, 2001; also 'Tax Compliance', Office of the Revenue Commissioners, August 2001, Department of Finance Tax Strategy Group, report 01/10, 2001). As American political scientist Margaret Levi has pointed out, where tax evasion can be practised with impunity this tends to erode the general legitimacy of the tax system even further: 'widespread compliance cannot thrive if people think they are suckers' (Levi, 1988: 177).

The Changing Economic Environment

Notwithstanding the ongoing problems of tax evasion and incomplete tax reform, the logic of the tax reform movement held sway over all governments during the 1990s. Indeed, there seemed little reason to question it. Governments were able to cut taxes and increase spending simultaneously. The remarkable spell of economic growth between 1994 and 2001 resulted in average annual growth in GNP of 7.9% (Department of Finance, 2002, Table 12); it also resulted in a growth in numbers at work of almost half a million, or some 40 per cent (Central Statistics Office, Labour Force Surveys). These buoyant economic conditions ensured a steady and rising flow of revenues to government. Yet, as Table 6 below shows, people on average industrial earnings were paying a little less in tax and social security than the OECD average, and a good deal less than the EU average.

Table 6. Income tax and employee social insurance as a proportion of average industrial earnings, 1998.

	Single, no children	Married, single earner 2 children
Ireland	24.9	18.1
OECD – total	25.5	19.9
EU 15	29.9	23.9

Source: OECD, *Taxing Wages 1998-99*. Paris: OECD, 1999, Table 3, p.46.

On the face of it, the relative size of the government tax take declined during the 1990s, making Ireland appear to be a model case of implementing tax reform objectives. But as we noted earlier, this was mainly an artefact of the statistics. As Table 7 shows, GNP was rising rapidly, and GDP more rapidly still. The role of the multinational sector in the Irish economy makes GNP a more accurate measurement of domestic growth. Whichever denominator is chosen, the trend indicates a fall in the percentage of the government's tax share, a trend shared in a number of other OECD countries over this period time too. But the volume of taxation was itself rising rapidly, fuelled by the continuing boom.

Table 7. Tax revenues as a proportion of GDP and GNP

	Tax+SI*, €bn	GDP €bn	GNP €bn	Tax+SI as %GDP	Tax+SI as %GNP
1980	3.9	12.0	11.5	32.6	33.9
1985	8.4	22.8	20.3	35.4	39.6
1990	11.8	34.5	30.5	34.2	38.7
1995	16.9	52.7	46.7	32.0	36.1
1996	18.4	58.1	51.5	31.8	35.8
1997	20.9	67.0	59.0	31.1	35.4
1998	23.5	77.1	67.7	30.5	34.7
1999	26.8	89.0	75.8	30.1	35.4
2000	30.8	103.5	87.1	29.8	35.4
2001	32.8	115.2	95.8	28.6	34.3

* Exchequer Tax Revenue plus PRSI plus Health Contribution

Source: Dept of Finance *Budgetary and Economic Statistics*, March 2002, Tables 4 and 11.

A similar trend is in evidence when one looks at trends in government spending, which fell from 45.4 per cent of GDP in 1994 to 39 per cent in 2002 (Department of Finance, 2002, Table 1). But in nominal terms, total government expenditure grew from €18.9bn in 1994 to €40.3bn in 2002, and the rate of annual increase stepped up sharply in the early 2000s.

The 1990s, then, seemed to be a decade in which government could have it all – engage in extensive tax-cutting strategies while also increasing public spending commitments, yet benefit from revenues so buoyant that not only could exchequer surpluses could be run by the end of the decade, but an annual investment could be made into a national pensions fund. Rapid growth deferred the moment when any hard choices would have to be made.

But the fiscal miracle could not last indefinitely. Events largely beyond the control of Irish governments began to alter the economic environment. A slowdown in the US economy began to ripple outwards in 2001 and 2002, and Ireland was more sensitive than most other European countries to changes in the flow of investment. GNP growth was estimated at about 5 per cent in 2001, and a projected 3 – 4 per cent in 2002, still respectable in comparative European terms, but a big drop on previous years' performance. Furthermore, the strengthening of the Euro began to change the terms of trade with the sterling and dollar areas. A decline in revenue buoyancy was already in evidence in 2001, when the exchequer balance was barely in the black, after three years of surpluses (Department of Finance, 2002, Table 5). A shortfall was widely expected for 2002 – a result due in part to the cost of tax individualisation for married dual-earner couples, in part to changes in the timing of revenue flows with the move in 2002 to calendar-year tax accounting and in part to the general economic slowdown.

Yet that other inexorable fiscal engine, that of public spending commitments, continued to gather pace in Ireland throughout this phase. Moreover, the results of the Public Sector Pay Benchmarking Body, set up under the terms of the social partnership agreement, the Programme for Prosperity and Fairness, reported in July 2002, recommending sizeable new increases for many public sector employees.

Furthermore, public expectations still ran high for an improvement in the quality of public services. While funding levels cannot be the sole measure of the quality of provision, Ireland in the late 1990s still ranked fourth lowest among the European 15 in the total volume of spending on social protection per capita, including both public and private sources of spending (European Commission, 2002, p.12). In areas such as health care and social services, many began to question what of lasting value remained after the years of plenty.

Only a short time before, the Fianna Fáil and Progressive Democrat government had anticipated cutting the top rate of tax from 42 per cent to 40 per cent. Following its re-election in May 2002, the issue seemed to be how to manage the public finances without having to revert to tax increases – but without having to make politically unpopular spending cuts either. How this could be done remained unclear. But what was amply clear was that the phase of policy innovation based on tax cuts had finally come to an end.

CONCLUSION

Issues of taxation typically elicit two types of reaction among people. The first is boredom, an all but complete indifference to broad patterns and trends, and incredulity that anyone apart from economists or accountants who were paid to do so could find tax issues interesting. The second is an impassioned engagement with the implications of the annual Budget for their own personal finances, often coloured by a deeply rooted cynicism about the justice of the system in general.

We have seen that political science can offer a different perspective which accords full weight to the deeply and inextricably political aspects of revenue policy. The profile of the dramatic changes in who pays, how they pay, and how much they pay, raises fascinating questions about how the crucial decisions are made. While we cannot shed any new light on the private deliberations of policy-makers here, we have shown that three perspectives can be brought to bear which help at least to frame the right questions. These have been termed inertia, innovation, and environment. It should now be clear that in each of the two phases we have examined, all three elements of explanation are needed to provide an adequate explanation. Perhaps at least by setting out the issues in this way, the ground can be cleared for others to provide more detailed examinations of the tangled issues involved in paying for government.

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