Commission on Taxation & Welfare
An Coimisiún um Chánachas ⁊ Leas

Briefing Paper

Strategic Reform

In the course of its work, the Commission has identified a number of significant strategic issues that arise in respect of the taxation and welfare systems, and which will need to be addressed over a number of years to come. It has been more than a decade since the last Commission on Taxation reported and it can be expected that it may be some time before another exercise of this kind is undertaken again. It is important, therefore, to consider how to further improve understanding and consideration of these strategic issues in the interim between major reviews, such as the one on which the Commission has been engaged.

This paper introduces the concept of Anticipatory Governance and points to a number of improvements which could be made to enhance debate and analysis of strategic policy issues in relation to taxation and welfare.

1. Introduction

In the course of its work, the Commission has identified a number of significant strategic issues that arise in respect of the taxation and welfare systems, and which will need to be addressed over a number of years to come. Some of the Commission's recommendations can be acted upon in the short term, but many of the issues discussed in the CoTW report will also require medium and long-term action. As the future is always uncertain, the Commission has placed considerable emphasis on the importance of taking a principles-based approach to the development of policy in the areas of taxation and welfare and has adopted principles which will remain valid, even as the context changes.

It has, however, been more than a decade since the last Commission on Taxation reported and it can be expected that it may be some time before another exercise of this kind is undertaken again. It is important, therefore, to consider how to further improve understanding and consideration of these strategic issues in the interim between major reviews, such as the one on which the Commission has been engaged.

2. Anticipatory governance

Given the explicit mandate in its terms of reference to consider the taxation and welfare system within a medium to long-term perspective, the Commission has made use of the Strategic Foresight approach described at meeting 3. As discussed at that meeting the methodology of strategic foresight involves identification of 'megatrends' which are likely to shape the future context for policy, globally and nationally, and consideration of how best to respond to different scenarios that may emerge as a result. Some of these megatrends are more certain than others, and as has been shown in previous papers, demographic change is subject to far less uncertainty than some other factors.

This methodology of strategic foresight is not new, and it has been adopted by a number of multilateral organisations such as the EU and the OECD. The European Union maintains a system called ESPAS (European Strategy and Policy Analysis System) which links multiple European Union institutions and which examines medium and long-term trends facing or relating to the European Union. The OECD is also active in this area, and during the period of the Commission's deliberations, the Irish Government has begun a project with the OECD on enhancing policymaking and strategic foresight, which is a welcome development. While Strategic Foresight has also been used by numerous national Governments, including Ireland, there are acknowledged difficulties in incorporating this kind of work into traditional governmental structures. Strategic Foresight and the linked field of Anticipatory Governance, explicitly attempt to tackle issues which are complex and uncertain and which are challenging for traditional policy development models.

Beyond the realm of taxation and welfare, the development of Strategic Foresight and Anticipatory Governance more generally lies outside the Commission's remit. There are, however, practical steps that could be taken to enhance on-going consideration of strategic issues that have a bearing on policy development in the areas of taxation and welfare. The outcome of the OECD work with Ireland may also lead to developments which will assist in this regard.

3. The budgetary process

The Irish system of public financial management owes its origins to pre-independence structures and legislation, and in particular the system of public finance that was established in the UK in the nineteenth century. Elements of our existing system, for example, are heavily based on the Exchequer and Audit Act of 1866, introduced by William Gladstone. The Act marked the culmination of a long process of reform in the management of public finances, designed to root out the inefficiencies and corruption associated with the Georgian era. It was also intended to copper-fasten core elements of 'Gladstonian Finance' including a minimalist view of what constituted appropriate Government spending. As result of the Act, the authority of the House of Commons and of the Treasury was enhanced, in terms of approving public expenditure in advance and auditing spending after the event, through the creation of the Comptroller and Auditor General and the Public Accounts Committee. The core elements of this structure remain in place in our present system, reinforced by constitutional provisions, legislation and parliamentary practice.

This system, in other words, owes its origins to a time when balanced budgets were an article of faith, and the scale and complexity of government activity was a fraction of what it is now. A core component of the system is its concentration on annual accounting. While multi-annual planning is not impossible under this system, Peden (2000) notes that:

'the system of strict annual accounting was designed to prevent a government from committing its successors to expenditure or taxation in future years'

In other words, maintaining a focus on the short-run was part of the overall objective of limiting the growth of public spending. The core elements of the system, which has important safeguards in terms of value-for-money have remained in place, even though, from 1911 onwards, the emergence of the welfare state meant that *'it was difficult to avoid moral, if not contractual, obligations in future years'* (Peden, 2000).

In recent years, the system has been enhanced through a combination of government initiatives and European requirements, in areas such as multi-annual capital envelopes, better distributional analysis, carbon budgets and programme budgeting. It is also welcome that the Government has also now committed to implementing a series of reforms in the area of public sector accounting. Moving away from the existing cash-based approach to a cross Government system of accrual accounting and consolidated financial statements will be transformative in helping to improve long term management of public finances and unlocking latent value from State assets. There have also been institutional enhancements, such as the creation of IFAC and the Parliamentary Budget Office. Yet, the system continues to have limitations when it comes to assessing long-run fiscal risks, and their implications for the tax and welfare system.

In its work, the Commission has benefited greatly from the work of IFAC and the Department of Finance on issues such as the implications of demographic change on fiscal sustainability. Nonetheless, there is a need to enhance analysis and discussion of medium-term and long-term issues, which would add an important dimension to the usual debates that take place about the annual budget. Given the challenges that Ireland faces, an injection of long-term thinking would be valuable.

4. Scenario modelling

Macroeconomic forecasts, of their nature, present important variables in terms of smooth graphs and average annual growth rates. In reality, economic turning points are extremely difficult to predict. There is no doubt that there will be numerous ups and downs in the 'medium to long-term' future that the Commission has been considering. This is of concern, not least in light of Ireland's experience during the financial crisis, when the collapse of unsustainable revenues from the real estate sector were a major factor in making the fiscal correction more difficult. There are numerous risks to growth and fiscal sustainability – what is not knowable is which will materialise and when, or whether several of them will materialise at once. In terms of developing tax and welfare policy into the future, therefore, it would be useful to develop a system of scenario modelling and associated stress testing, to examine different future public finance scenarios and how well the state could react to them. This should be conducted on a cross-departmental basis and could be linked to the National Risk Assessment Framework.

5. Policy levers

A simple question to ask, arising from such a stress-testing exercise, or similar consideration of long-term issues, is whether Ireland currently has the policy levers and administrative capacities and structures necessary to deal with scenarios that may, or indeed will, arise in the future. Another lesson from the financial crisis and the pandemic, is the difficulty in designing new fiscal instruments under crisis conditions. The fact that Revenue had completed a major reform in the PAYE system was central to its ability to deliver supports during the pandemic. Such a system could not have been created quickly otherwise.

The Commission has pointed to the need for new tax instruments to be developed in the area of road usage and site value. These are projects which, if adopted by Government, will take several years to implement, in terms of detailed design, building administrative systems, and phasing-in. Once in place, however, these 'levers' can be adjusted to take account of changing circumstances. It is important to consider on an on-going basis, how well Ireland is positioned to deal with fiscal risks that may materialise, and whether there are adequate policy tools and administrative systems in place should they arise.

6. Medium-term reform road-maps

As part of this work, there is merit in making greater use of medium-term reform road-maps, such as those adopted by the Government on taxation matters such as Carbon Tax and Corporation Tax, and on the social welfare matters such as the Roadmap for Social Inclusion and Pathways to Work.

By setting out a multi-annual road-map for the trajectory of the Carbon Tax, the State is sending a strong signal about the direction of policy over a period of years, and providing certainty as to the direction of travel on carbon pricing. This provides a strong incentive for people to invest in alternatives to carbon, while also providing time to make the necessary adjustments. There would be merit in adopting a similar approach in other areas. While Government will always need flexibility to respond to circumstances, there is merit in giving greater certainty about how tax and social welfare policy is likely to change in specific areas. The development of such road-maps also provides an opportunity for stakeholder engagement as appropriate.

Moreover, in some areas of taxation and social welfare, reform will undoubtedly require a process of planning over several years. The Commission's recommendations on road-taxes and on commercial property taxes will require detailed planning and project management as will some of the recommendations in relation to social welfare. Setting out road-maps in these areas, would also improve economic efficiency, by providing certainty as to the direction of travel.

7. Performance reporting

The existing system of public financial management is derived from a time when strict limitation of Government spending was an over-riding goal. While this structure has carried over into modern audit and accountability for direct expenditure, as noted in the Secretariat papers on tax expenditures papers from Meetings 5 and 9, the high level of resources committed to various policy goals through tax expenditures does not receive the same level of scrutiny. Indeed, there seems to be a view that tax expenditures are 'free' and that policy objectives can be pursued through tax expenditures at no cost to society or the economy.

The Commission has endorsed the general rule that a market failure should be identifiable and that direct expenditure options should be examined before a tax expenditure is adopted. Moreover, one should also look for evidence of policy coherence, and for alignment between the policy objectives being pursued through direct expenditures and tax expenditures, such that the mix of both types of measure is appropriate and likely to achieve the stated policy objective.

To further this goal, information on tax expenditures relevant to particular Departmental votes could be included in expenditure reports and Appropriation accounts. The formal accounting for direct expenditure could be accompanied by information notes on the extent of tax expenditures being directed at related policy objectives. Public Service Performance Reports, which are based on the concept of Performance Budgeting, include information on the total amount of expenditure allocated to each Department and what has been achieved with these resources. They do not, however, include information on tax expenditures. This could be changed so that outputs are assessed against the total level of resources, direct and indirect, being allocated to the policy objectives concerned.

8. Data collection

Just as tax expenditures are not free, neither is data collection. Collecting and collating data involves the deployment of scarce resources. This in turn means that choices are required as to which data should be collected and how it should be reported. The Commission may wish to make recommendations about improved collection of data to facilitate policy analysis in respect of taxation and welfare within Departments and Agencies, linked to a broader strategic approach to data collection generally.

9. Skills

Improving the evaluation of tax and welfare policies, and better policy development generally, relies on having enough people with the right skills. Significant advances have been made through the development of IGEES – the Irish Government Economics and Evaluation Service, and IGEES staff are currently working across a variety of Government Departments. It is important to bear in mind, however, that economics is not the only relevant skill set required to do this work. The Department of Finance, the Department of Social Welfare, and Revenue, have for example, invested heavily in developing tax skills among their staff, including through recruitment from the private sector, as well as enhancing capacity in data analytics. The Commission may wish to comment on the importance of maintaining and enhancing the skills required within the public service to conduct strong evaluations of tax and welfare policies, including tax expenditures.

10. Discussion

The Commission may wish to consider commenting on the importance of improving on-going consideration of strategic policy issues in respect of taxation and welfare, and making recommendations on some of the concrete options listed in this paper.