

Fiscal decentralization in Ireland

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Executive Summary

- *Ireland is in a highly unusual situation regarding fiscal decentralisation: effectively, it has had none since the late 1970s. Therefore, on any hypothetical scale or index Ireland lies at the highly centralised end of the spectrum.*
- *The rating system of local government funding, inherited from Britain after independence in the 1920s, was abolished in 1977/78. Since then Irish local government has relied on grants from central government for the bulk of its expenditure needs.*
- *The reduction in the number of councils, and abolition of local rates, coincided with a huge surge in Irish public expenditure in the 1970s. This state of affairs swelled the national debt. It is only since 1987 that serious progress been made in reducing this debt.*
- *Despite the economic improvements of the 1990s, it has not yet become politically mainstream to call for a reform of the nation's system of taxation. In the context of an asset price boom this silence is understandable even if the economic consequences are deleterious.*
- *The increased centralisation of revenue raising powers in Ireland has been complemented by the simultaneous centralisation of expenditure decisions. Since the 1970s councils without taxation power have increasingly only administered the expenditure decisions taken in Dublin and Brussels.*
- *Harmonisation of tax rates throughout the EU is a controversial topic within Ireland. Ireland's relatively low rates of corporate taxation have encouraged inward investment and any proposed increase in corporation tax due to harmonisation would reduce Ireland's growth potential.*
- *There is little evidence to support the view that such harmonisation would eliminate distortions caused by transfer pricing as the empirical evidence suggests that transfer pricing does not explain Ireland's productivity performance.*

- *Politically there has been no serious move to move Ireland to a more decentralised tax base. Ireland's political parties reflect public opinion that prefers not to pay rates.*

- *Theoretical models of fiscal centralisation must take account of the politics of moving towards decentralisation. In the Irish case there are considerable forces for organisational inertia. Overcoming these forces is currently beyond the willingness and ability of political leaders within Ireland. If however the EU advocated shifts towards decentralisation then the situation would change.*

'Europe owes its rise to a economic and intellectual centre to the competition among governmental units'.¹

'The uncivic mentality of the [Irish] voter expects little of government other than hand-outs, and by voting in accordance with such expectations deserves to get governments of which little can be expected. In fact, the Irish have probably got, on average, governments somewhat better than they deserved'.²

'[A comprehensive local property] tax would offer a considerable potential for reducing reliance on income and expenditure taxes. We recognise the difficulties involved but we consider that such a tax could be introduced in an efficient and fair manner, and that its introduction could result in a much less distorted tax system and one which had much more favourable incentive effects'.³

1. INTRODUCTION

1.1. Background

It has been observed that while the respective theoretical merits of fiscal centralisation and decentralisation are debatable, it is even more difficult to empirically assess the degree of centralisation that exists in the real world. In particular, there is no index of the degree of comparative fiscal autonomy that exists.⁴ This report aims to contribute to creating such an index by considering the past and present structure of taxation in the economic and institutional development of the Republic of Ireland. In line with the aims and objectives of the IREF this study considers the connections between the degree of fiscal decentralisation and institutional competition in the context of the Republic of Ireland. At the outset it should nonetheless be stated that the Irish Republic over the last decade, when judged in terms of the centralisation of tax and spending, has

¹ Frey and Eichenberger, 'FOCJ: Creating a Single European Market for Governments', p.196.

² Garvin, 'Democracy in Ireland: Collective Somnabulance and Public Policy', p.43.

³ The Industrial Policy Review Group, *A Time for Change: Industrial Policy for the 1990s* (The Culliton Report), p.41.

been at the highly centralised end of the economic spectrum. The extent of this centralisation cannot be underestimated, and this fact alone is vital to understanding the political economy of fiscal centralisation and decentralisation in the Irish case.

Table 1.1.1 illustrates how the level of and composition of Irish tax revenue changed in the period 1965 to 1996. The empirical evidence demonstrates that Ireland has long had a centralised tax system that has got progressively more centralised in recent decades. It can be seen that during the period, taxes on income, profits and capital gains made up just over a quarter of Ireland's total tax base in 1965. Yet by 1996 the same category of taxation counted for 40.9 per cent of the tax base. In terms of local taxation, which falls under the rubric of taxes on property in the OECD definition, the centralisation of the tax base can be clearly illustrated. Whereas in 1965 15.2 per cent of the nation's tax revenue derived from property sources, including the rates, by 1996 only 4.8 per cent did. Of course in the intervening decades the rates had been abolished in Ireland.

Table 1.1.1. Details of Irish Tax Revenue, 1965-1996.

		1965	1970	1975	1980	1985	1990	1993	1994	1995	1996
Total Tax Revenue	Tax	250	506	1196	3187	6762	9574	11716	13016	13589	14880
<i>Taxes on Income, profits and capital gains</i>		64	137	359	1164	2333	3532	4703	5237	5316	6090
<i>Social Security</i>		16	42	165	455	997	1421	1802	1883	1959	2004
<i>Taxes on Payroll and workforce</i>		-	-	-	7	158	125	236	216	164	166
<i>Taxes on Property</i>		38	62	116	168	270	448	488	580	613	712
<i>Taxes on Goods and Services</i>		131	265	556	1393	3003	4049	4487	5094	5537	5909

Note. Details of Tax Revenue in Millions of Irish Pounds

⁴ King, 'Local Taxation: Some Lessons From Europe', p.111.

Source: *OECD Economic Outlook*, December 2001.

The empirical evidence in 1.1.1 is not an isolated case. There are many empirical studies which all confirm that Ireland has an enduring record of fiscal centralisation. Out of a 1991 survey of the fourteen member states of the Council of Europe, Ireland was ranked at the very bottom of the rankings for local responsibility.⁵ Moreover, centralisation has also been the norm in terms of tax yield. In a 1993 study covering all OECD members, only Greece and Italy had a lower state and local tax yield as proportion of GDP.⁶ Table 1.1.2. below confirms that compared to other small unitary European countries Ireland between 1973 and 1986 was also relatively centralised in its tax base. As will be shown later in this report this state of affairs has not been helped by the abolition of local taxes in the late 1970s.

Table 1.1.2. Local taxes in Small Unitary European Countries as a Percentage of Total Tax Base.

	1973 %	1986 %
Belgium	4.8	5.1
Denmark	28.1	27.3
Ireland	8.7	2.4
Luxembourg	12.8	11.7
Netherlands	1.4	2.2

Source: OECD, *Revenue Statistics of OECD Member Countries* (Paris, 1988).

As will be examined in more detail later in this report, Ireland's local authorities are funded via central government grants. Taxes therefore account for only a small proportion of local revenue. This high degree of fiscal centralisation is a long-standing one, between independence in the 1920s and local government reform in the 1990s the Republic of Ireland witnessed a successive redistribution of power away from local government and towards central/national government. As early as 1967 the Maud committee on the Management of Local Government in Britain having considered seven

⁵ Hussey, *Ireland Today: Anatomy of a Changing State*, p.100.

⁶ King, 'Local Taxation', p.116.

countries, concluded that in Ireland 'Central control was the most stringent of all'.⁷ By 1978, uncoincidentally prior to a general election, the process of centralisation culminated as Ireland witnessed the abolition of all local authority rates.⁸ This policy adjustment relieved all owner-occupied residential property from a politically unpopular annual property tax. It must be reiterated that it was the political unpopularity of the rates rather than any deliberate institutional plan to adjust the relationship between local and national government that accounted for abolition.⁹ The elimination of rates on residential property was followed by legal action by agricultural interests that removed the other main source of revenue (farm rates) and this major development left Ireland's system of public finances even more centralised than it was at the time of the Maud report.¹⁰ In 1983 a residential property tax (RPT) was introduced. The yield from RPT was very modest (it was a mere IR £ 7.2 million in 1992).

It is also notable that between 1978 and 1992 a series of reports by a range of official government bodies including the commission on taxation, the Culliton commission and reports by the National Economic and Social Council (NESCC) repeatedly called for the restoration of a widely based form of local taxation.¹¹ The official clamour for such a reform however diminished as it soon became apparent that a more localised version of taxation would coincide with a boom in the property market. The position in the economic cycle in Ireland therefore has important implications for the political acceptability of reforming the structure of taxation. The high degree of home ownership, Ireland has at 82 per cent the highest proportion of home-owners in the industrialised world, has important implications.¹² In particular it means that any local taxation linked to the value of housing is a political non-starter in times of booming house prices. The extent of Ireland's recent housing boom should not be underestimated

⁷ Hussey, *Ireland Today*, p.97. Spatially speaking Ireland's system of government has long been centralised in its capital (Dublin) to an extent not matched by other European countries. In 1976 only a quarter of French civil servants were based in Paris, while two thirds of Irish civil servants had offices in Dublin. Barrington, 'Can There Be regional Development in Ireland?', p.356.

⁸ The timing of elections to local government in Ireland is determined by central government. This state of affairs has ensured that central governments have delayed local elections when national trends were moving against the government. They were postponed in 1965, 1972, 1984 and 1990. There was virtually no public protest. *Ibid* p.101.

⁹ King, 'Local taxation', p.113.

¹⁰ Hussey, *Ireland Today*, p.98.

¹¹ De Buitelir and Thornhill, *EMU and Irish Fiscal Policy*, p.56.

¹² The Economist, 'Special Report: House Prices', p.64.

either. As Table 1.1.3 below demonstrates, in the two decades since the abolition of rates Ireland has witnessed the second biggest increase in house values in the industrialised world. What is more, despite slowing economic growth Irish house prices in 2001 grew in real terms at more than twice the rate of the global index. Dublin house prices in the period 1980 to 2001 grew by 207 per cent (also in real terms).¹³ This increase was more rapid than any other city in the survey.

1.1.3. *The Economist House Price Index.*

	% Change 1980-2001 Nominal	% Change 1980-2001 Real	% Change in 2001 Nominal	% Change in 2001 real
Spain	726	124	15.4	11.4
Ireland	451	95	14.0	8.6
Britain	389	89	10.5	8.5
US	158	20	8.6	5.6
France	155	15	6.9	5.1
Global Index	148	19	5.4	3.2

Note: adjusted for consumer price inflation
Source, *The Economist*, March 30th 2002, p.66.

More generally, the centralisation of getting, spending and other powers in the Ministries of Finance and of the Environment have led a number of Irish commentators to declare that the Irish system of government is subject to a chronic 'democratic deficit'. This indeed was the assumption behind the Barrington committee, which comprised of a group of experts concerned with examining the structure and functions (but not the funding) of Ireland's local government. The committee's final report (published in March 1991) would have transformed the structures of governance in Ireland had they been fully implemented. Yet in line with many other areas of Irish public life, attempts at reform ran up against the inertia associated with powerful vested interests and little of the suggested innovations were actually introduced.¹⁴ The actual legislation based on the report for instance conspicuously failed to consider the issue the lack of financial power enjoyed by

¹³ Ibid, p.65.

¹⁴ Hussey, *Ireland Today*, pp.95-98. Hussey notes that previous government proposals for reforming local government in a Government White Paper in 1971, a government discussion paper in 1973, a government undertaking in 1987 to reform the system of local government all came to nought.

local government.¹⁵ This unsatisfactory situation led one distinguished political commentator in 1993 to write of Ireland's system of local government and finance that it was 'neither local nor government'.¹⁶

Ireland's economic status as a small open economy has had a profound impact on the conduct of fiscal policy.¹⁷ More precisely, it has ensured that in terms of tax levels Ireland's more politically prudent policy makers have had to be careful to balance international competitiveness with political demands for improvements in government provided services. The pursuit of competitiveness necessarily involves restraining tax levels, while acceding to political demands often requires higher tax revenues. Thus, even if the composition of the tax yield has been far more centralised than in many other states, policy makers mindful of the economics and politics have repeatedly had to ensure that Irish tax levels did not veer to far out of line with other states. Since the abolition of rates they have had to steer this course within a framework of centralised fiscal policy. As will be shown later in this report, when policy makers have opted for excessive public expenditure growth, the results have been adverse for long-run economic growth.

Ireland's high and rising level of openness to international trade also means that it is probable that the heavy centralisation of revenue raising/expenditure making decisions in Dublin is especially inefficient. Central government's reliance on taxing consumer expenditure and incomes rather than local property means that its tax base is concentrated on a relatively mobile factor of production (labour) rather than an immobile one (land). It is probable that Ireland's enduring tradition of emigration, and more recent 'brain drains', may be connected to the centralised nature of its taxation. Irish workers, regardless of their level of skills and educational background, have been encouraged migrate towards lower taxed labour markets.¹⁸ By 1991 the British workers take home pay after tax was 6 per cent higher than Ireland's for a single worker and 4.5 per cent for a married one.¹⁹ Many high earners left Irish shores in the 1980s, and this skewed income distribution and undermined native entrepreneurship. It is probable (we can only say probable because of

¹⁵ The final act was instead concerned with the timing of elections and altered planning legislation.

¹⁶ Ibid, p.95.

¹⁷ Reynolds, 'Introduction', p.1.

¹⁸ Irish workers have been historically highly mobile between ROI and GB. There is an extensive economic history literature on this very point.

the absence of empirical studies) that overall the transition away from property taxation since the 1970s has been on balance detrimental to the attainment of both efficiency and equity in Ireland.²⁰

Any sophisticated discussion of centralisation and decentralisation of governmental expenditures, responsibilities and taxation in the Irish case must recognise firstly, the weight of influence that British rule had over the institutional frameworks that Ireland inherited at independence (and has continued to experience in the intervening eight decades).²¹ Secondly, despite the increased role of Europe, the UK market continues to play a vital role in shaping Ireland's economic performance. Returning to the high Irish propensity for emigration, there is significant empirical and historical evidence that Ireland has operated within a labour market covering the whole of the British Isles. The existence of a common labour market has meant that the level of Irish real wages has been affected by earnings trends in the UK economy. It follows therefore that the autonomy of Irish governments in levying the overall income tax burden (and the related ability to control migration flows) has to a large extent been further circumscribed by the existence of a common labour market. Irish governments free rode on Britain's fiscal expansion as the pursuit in the UK of expensive Keynesian demand management and redistributive welfare policies in the pre stagflation world of the 1950s, 60s and 70s allowed Ireland's tax rates to rise in response to trends in the UK. Conversely, as tax rates in the UK fell in the 1980s Ireland, burdened by a huge government debt, could not benefit to the same extent in tax reduction.

This centralisation and the legacy of British rule has profoundly affected the pattern of getting and spending public finances in Ireland. The contemporary Republic of Ireland inherited the system of statutory local government from Westminster's Local Government Act, 1898. Nearly a century later, with the exception of the changes brought about by the creation of a county management system in the 1920s, Ireland still had

¹⁹ Moreover, Britain's highest rate of tax (40 per cent) was 12 per cent below Ireland's. De Buitler and Thornhill, *EMU and Irish Fiscal policy*, p.24.

²⁰ Ibid, p.56., De Buitler, 'Taxation and Ireland: Outlook', p.183.

²¹ The Irish tax system was inherited from the UK. Over the subsequent seventy years piecemeal developments have occurred such as the introduction of Pay As You Earn (PAYE) in 1960 and Value Added Tax (VAT) in 1972. Only in the 1974 budget (and the resulting Finance Act) did a unified system of personal income tax emerge. In 1976 the Corporation Tax Act introduced corporation tax on company

virtually the same system of local government as it inherited at the time of independence.²² It is no exaggeration to say therefore, that the constitutional economics of contemporary Ireland still lives with the perceptible influence of Victorian Westminster. Another influence in the structure of institutions in Ireland is the American model of municipal affairs. The American model of local government followed the example of business. It was also introduced in Ireland when independence occurred. Thus Ireland's system of city and county managers was born in the 1920s: since then professional full-time local managers have run the local authorities in unison with elected representatives. It is important to note that these elected officials remain part-time and virtually unpaid.²³

Vested interests in Ireland benefited from the surge in public expenditure that occurred in the Golden Age, and this factor has also affected public finance arrangements in Ireland.²⁴ The inertia in reforming the level of fiscal centralisation in Ireland has in particular been attributed to the considerable powers that vested interests have exerted and continue to exert in the Irish system of central and local government.²⁵ This is a theme that will be returned to later in this report in sections 2, 4, 5 and 6 especially. Reform of the Irish system of local government has until now been focused on a rationalisation of the number of local authorities. Between 1920 and 1993 the number of councils was reduced from 460 to 117.²⁶ Central government has thus clawed back even more political power as it has simultaneously come to dominate economic activity. In this connection the dual mandate, the rule which allows sitting members of the Irish parliament (TDs) to also sit in local councils, is a salient influence on political development.

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profits and in 1979 pay related social insurance was introduced. The abolition of domestic rates in 1978 therefore stands in stark contrast to the introduction of new taxes during the 1970s.

²² McNamara, 'Government Without Citizens: the Irish Experience', p.312.

²³ Hussey, *Ireland Today*, p.96.

²⁴ Hussey ably discussed the role of local government in this. *Ibid*, p.106.

²⁵ McNamara, 'Government Without Citizens', p.312.

²⁶ By 1993 there were 27 county councils (Tipperary has two) 5 county borough (city) councils and 6 borough corporations, 49 urban district councils; and 30 town commissions.

The preceding discussion suggests that on any hypothetical scale or index of fiscal centralisation and decentralisation, Ireland must lie on the extremely centralised end of the spectrum. The causes and consequences of this observation are covered in this report in the following format. In section 2 the historical context behind the dynamics of fiscal centralisation and decentralisation in the Irish case are briefly outlined. It is noted that Ireland inherited at independence a centralised system of finance and that over time this degree of centralisation of revenue raising has grown. It is also demonstrated that one of the major implications of public expenditure growth was to increase the power of central government relative to local government in making expenditure decisions. Section 2 concludes with a discussion of the public finance implications of the high rates of economic growth that Ireland witnessed in the 1990s. It is further suggested that Ireland's system of public finance has been characterised by institutional inertia. Namely, when the economy has grown strongly, as was the case in the 1990s, this has tended to inflate the Irish housing market. These inflated asset prices mean that the introduction of any local tax based on residential property values will be politically difficult to introduce and implement. There is marginally more chance of reforming the system of public finance when the economy starts to grow slowly, but even in this case the prospects should not be exaggerated.

In section 3 the current state of fiscal centralisation in Ireland is discussed in more detail. It is noted that since the abolition of rates in the late 1970s central government has usurped many of the roles of local governments in service provision. By way of illustration, since the early 1990s specific grants from the national exchequer have accounted for around 80 per cent of all the capital expenditure undertaken by local authorities. Because local authorities have no independent rates to cover the remaining 20 per cent, they have had to introduce a series of rather *ad hoc* water, refuse collection and service charges and charge for planning applications. There are currently wide areas of the Irish economy for which lower levels of government have no real autonomy. For central government the result of this rather unsatisfactory state of affairs is that VAT and income tax must bare the burden of paying for local services. It will be shown that this centralised state of affairs has emerged because of the political wishes of senior

politicians and civil servants. It is not how the system need operate in a formal legal sense.

In section 4 the political economy of EU tax harmonisation, and how it will affect Ireland, is considered. Ireland's reliance on low rates of corporation tax as a means of stimulating inward investment has long been recognised by its academic, political and business communities as a major source of its economic convergence over the last three decades with the major developed economies. Some commentators have argued that much of this convergence is a statistical trick due to transfer pricing. Such commentators suggest that tax harmonisation would hence be justified because it would allow a more 'rational' regime of economic management to emerge. Yet it is suggested in section 4 that this justification for tax harmonisation is spurious. The empirical evidence does not suggest that transfer pricing has been an overarching economic issue. In any case, any further harmonisation of Irish corporation tax would be in an upward direction. Any such alteration would tend to damage the international competitiveness of Ireland as an industrial location. Public and political opinion within Ireland is thus right to be suspicious of this element of the EU's plans for harmonisation.

In section 5 the state of public and political opinion in Ireland on issues of taxation is surveyed. Ireland has a very populist political system. The nation's political leaders and the electorate are unusually vulnerable to influence by each other. For this reason, it is notable that there has been no serious policy move towards a broadening of Ireland's tax base via the creation of a more decentralised tax system. Irish political parties in the last election (and currently) were and are more concerned with harmonisation of corporation tax and the nation's uncertain growth prospects. If a reform of the public finances was politically popular there is no doubt that at least one of the four major parties would have adopted this as official party policy.

In the final section of the report some theoretical perspectives on the political economy of fiscal centralisation (and centralisation) are considered. It is noted that King's model suggests that only when public opinion is willing to tolerate a non-uniform standard of services and democratic representation will decentralised systems endure. Frey and Eichenberger's model of decentralisation is also discussed. It is suggested that their model, regardless of its economic benefits, fails to acknowledge the political

complexities of fiscal centralisation in the Irish case. Their model however has similarities to parts of Irish political life such as use of referenda. This feature might be a useful starting point for creating a blueprint for future institutional reform. It is concluded that Ireland will not unilaterally adopt fiscal decentralisation, regardless of its economic merits, because the political costs are considerable. On the other hand, if the EU encouraged countries to shift away from harmonisation towards decentralisation then Ireland would follow suit.

2. FISCAL POLICY AND DECENTRALISATION IN THE REPUBLIC OF IRELAND: THE HISTORICAL LEGACY

2.1. Introduction

How far back in time need one go in order to understand a nation's economy? Economic historians and economists are divided between those who see recent events as outweighing those of the remote past and those who view remote events as crucial to understanding the economic present. Economists often take the view that only the last few years or decade at most is sufficient for explaining trends in contemporary economic organisation. Yet a more historically grounded or long term perspective may be necessary however if, following Weber, one believes that a nation's 'ethos' is predetermined and that only economic institutions compatible with this ethos can prosper and evolve.²⁷ In terms of the topic of the degree of fiscal decentralisation in the economy of Ireland there is no escaping what Tony Blair termed, albeit taken from another Irish context, the "hand of history". History matters to the dynamics of decentralisation. It must be borne in mind that the system of local government largely dates from the 1920s and the abolition of the rates dates from the 1970s. As the situation has been largely unchanged for the last twenty-five years it therefore is clear that the dynamics of fiscal centralisation in Ireland requires some kind of historical analysis. In the following section each of these aspects of Irish economic history are drawn out and their implications for fiscal policy are outlined.

2.2. A Brief Survey of Ireland's Fiscal Record 1920-1992

A survey of the Irish Republic's long-run economic performance was published in *The Economist* in 1988. It included the following extract that goes to the core of Ireland's fiscal performance until the 1990s:

'Take a tiny, open, ex-peasant economy. Place it next door to a much larger one, from which it broke away with great bitterness barely a lifetime ago. Infuse it with a passionate desire to enjoy the same lifestyle as its former masters, but without the same industrial heritage or natural resources. Inevitable result: extravagance, frustration, debt'.²⁸

As the introduction to this report indicated, like so much else in the contemporary Republic of Ireland, Irish attitudes to the application of economic management and institutions have been greatly influenced by the enduring legacy of British rule. It is no exaggeration to write that until fairly recently Ireland's political independence was not in any real sense paralleled by an intellectual independence from British ways of conducting economic policy. Moreover, Ireland's status as an agricultural producer should not be underestimated as a determinant of the structure of its tax and expenditure system. The reliance of successive Irish governments on agricultural output and farming votes skewed fiscal policy in certain directions. Cumann na nGaedhael provided the first Free State government between 1922 and 1932.²⁹ The new governments desire to establish international diplomatic respectability and financial credibility while restoring domestic political stability ensured that despite the attainment of political independence the scale and scope of government intervention was not appreciably expanded in the 1920s. In any case, any possible radicalism was further tempered by the government's reliance on the votes of large scale farming interests. Consequently, income tax accounted for only a fifth of the total tax base in the first decade of independence. At this early stage the vast bulk of Irish taxation was derived from customs, excise and indirect taxes, and in 1926

²⁷ Bradley, 'The Two Economies of Ireland; an Analysis', p.38.

²⁸ *The Economist*, January 1988 cited in Hussey, *Ireland Today*, p.240.

²⁹ The Republic of Ireland was called the Irish Free State until 1937 when it became Eire, it was only in 1949 that the current name was introduced. Throughout this study I tend towards using the term Ireland to denote the Republic of Ireland.

agricultural land was derated. This political and economic settlement maintained a balanced budget as it hindered the growth of taxation and social welfare expenditure.

Only in 1932 with the election of a new Fianna Fáil government in 1932 did the structure of Ireland's fiscal system start to change appreciably from the pre-independence settlement. In line with the populist mood of the period, a system of protectionist tariffs and increased social welfare spending was initiated. Lest this should be interpreted as a birth of Keynesianism in Ireland, it should be noted that balanced budgets still remained the norm, and while public expenditure grew, so did the width and breadth of the tax base. As late as 1946 Ireland's budget deficit was only a minuscule IR £16 million. Hussey has concisely summarised the major influences on economic policy-making in the first three decades of political independence:

'In very many ways, Ireland followed a recognizable post-colonial pattern: initial commitment to and obsession about getting structures of self-government into place, a desire for economic self-sufficiency (accompanied by isolationism in many other facets of national life like censorship), no export-led economic policies, all exacerbated by Ireland's geographical location as an island off an island off a continent'.³⁰

It is notable for any study of the dynamics of fiscal centralisation to observe that Ireland did not open up its markets to foreign competition until the 1960s and 1970s and tariffs provided their highest level in 1956-7. The gradual evolution to a more liberal outward looking economic regime nevertheless was to prove to be a false dawn in Irish economic performance. Rising prosperity sowed the seeds of its own destruction as too much money started to chase too few goods. In line with other developed economies however, the boost in economic growth due to trade liberalisation brought with it an increased demand for a greater role for public sector expenditure.³¹ For instance, government educational expenditure ballooned in response to free secondary education in 1967. This new situation of public sector growth reached its peak (or nadir if you prefer) in the spending spree of the late 1970s with a dramatic escalation in government expenditure.

³⁰ Hussey, *Ireland Today*, p.241.

³¹ Bradley, 'The Two Economies of Ireland', p.43.

In Ireland, as with most other developed economies, the evolution of the economy during the heyday of the Keynesian welfare state was associated with an increase in government involvement in economic activity. This extent was a long-run consequence of political independence, but it was accelerated by more activist fiscal and social policies. The total expenditure of public authorities (including transfers) rose relative to GNP from less than 25 per cent in the mid 1920s to nearly 70 per cent sixty years later. While there were sharp upward shifts in the ratio of public expenditure in the 1930s and from 1947 to 1951, the really large increase has been since 1960, when it was 32 per cent. More particularly, the period 1973-85, when the ratio rose from 42 per cent to 67 per cent, stands out as the major shift in the fiscal environment.³²

Hussey, in line with the orthodoxy in Irish academia and media, attributes the economic progress made in the 1960s with the often interventionist economic policies pursued by the Secretary of the Department of Finance, T.K. Whitaker and his Taoiseach (prime minister) Seán Lemass. The author has elsewhere dubbed as the 'big bang' the perspective that Ireland's economic transformation can be traced back to Lemass and Whitaker.³³ Hussey has expressed this mainstream view of this false dawn in Irish economic development as follows:

'Those optimistic days when Ireland began to seem at last like a place where its young could find work for life, when foreign investors crowded in to take advantage of both generous tax incentives and a lively young and literate workforce, when politicians presided over a well-ordered and growing economy were halted by a combination of external economic upheavals at the end of the decade, and the internal weaknesses of resolve to deal with those problems independently...Irish ministers and trade unions, having become accustomed to the prosperity of the 1960s, wanted to have it all-and more-in the 1970s, despite clear evidence that it could not go on'.³⁴

Elsewhere the author has demonstrated that the mainstream or 'big bang' account however seriously exaggerates the general role of government intervention in stimulating

³² Kennedy, Giblin and McHugh, *The Economic Development of Ireland in the Twentieth Century*, p.87.

³³ Likewise, again in line with the orthodox view, she has suggested that their retirement led to Irish policy makers being unable to respond to the economic challenges of the 1970s and 1980s. See Brownlow, *Institutional Change in the Two Irelands, 1945-90: an application of North's Institutional economics*.

³⁴ Hussey, *Ireland Today*, p.243.

the economy and the specific role of Lemass and Whitaker in reforming the economy.³⁵ Returning to a recurrent theme of this paper, Ireland's inability to manage its microeconomic, monetary and fiscal policies were overwhelmingly due to internal political factors often associated with the large role of lobbying in Irish political life. In particular, despite the low revenue base, Irish policy makers were keen to see promised improvements in social welfare and health regardless of the implications on the public finances. Ireland's unions and the electorate were both committed to emulating the British welfare state without attaining comparable levels of output. Even pro-interventionist accounts of Ireland's economic record now concede that the persistent political demand for equality in all social services with the United Kingdom and other advanced industrial nations notwithstanding Ireland's historically low GDP per capita has been a mistake.³⁶

The bungling attempt to mitigate effects of the oil shocks via expansionary Keynesian policies was perhaps inevitable in a political climate that had a tendency to engage in spending sprees. The major financial consequence of these inept attempts at stabilising the economy was to saddle the taxpayer of Ireland with a huge public debt. Of special importance to this trend was the 1977 'bread and circuses' general election. The abolition of domestic rates, higher spending and more borrowing were all part of the victorious Fianna Fáil campaign. Table 2.2.1 below demonstrates that despite repeated promises to put its financial house in order, the national debt continued to grow into the late 1980s. Furthermore, it was inevitable that the adverse effects of this binge would be followed by an equally painful attempt to cure this hangover in the late 1980s. The failure of Ireland's experiment in bread and circuses was total. It is notable that unemployment grew to 17% of the labour force in 1986 with net emigration accounting for 1 per cent of the population.³⁷ The early 1980s saw the worst effects of economic recklessness. Inflation went to 21 per cent in 1981 and the current account of the balance of payments deficit accounted for 15 per cent of GDP. The attempt to restrain the twin (trade and budget) deficits caused taxation as a share of GDP to jump by 9 per cent in as many years.³⁸ In such an environment altering the balance between local and national

³⁵ Brownlow, *Institutional Change in the Two Irelands*.

³⁶ Hussey, *Ireland Today*, p.244.

³⁷ Honohan and Walsh, 'Catching Up With the Irish Hare', p.8.

³⁸ *Ibid*, p.8.

responsibilities for fiscal policy would be ignored because of more urgent issues in the public finances.

Table 2.2.1 National Debt as a Percentage of GNP/GDP.

Year	GNP	GDP
1982	94	87
1983	106	97
1984	114	103
1985	117	104
1986	128	114
1987	129	117
1988	128	113
1989	117	102
1990	110	98
1991	107	95
1992	101	91

Source: De Buitelir and Thornhill, *EMU and Irish Fiscal Policy*, p.9.

Table 2.2.1 above shows how national debt in relation to national income reached a peak in 1987 but declined steadily before the creation of the single European market in 1992. The binge in public sector spending due to the addiction of Irish politicians to pork barrel spending was only curtailed by the introduction of a new macroeconomic framework in 1987. Honohan and Walsh have summarised the key features as follows:

'The specific fiscal steps taken in 1987 were quite conventional: a temporary freeze on public sector employment combined with (further) cutbacks in public capital spending. The better external conditions helped turn the automatic stabilizers around, as first emigration and then a pick-up in labour demand

lowered unemployment. Falling interest rates also helped and when the debt ratio started to fall the positive feedback became cumulative'.³⁹

Nevertheless, the degree of improvement associated with this new regime while undoubtedly profound should not be exaggerated.⁴⁰ Table 2.2.2 shows that relative to other European economies, Ireland's gross public debt burden still remained a profound problem as late as 1992.

Table 2.2.2 Gross General Government Debt as % of GDP 1992.

Country	% of GDP
<i>Belgium</i>	130
<i>Italy</i>	104
<i>Ireland</i>	100
<i>Greece</i>	99
<i>Netherlands</i>	80
<i>Portugal</i>	67
<i>Denmark</i>	66
<i>France</i>	48
<i>Spain</i>	46
<i>UK</i>	46
<i>Germany</i>	44
<i>EC Average</i>	63

Source: *Financial Times*, 14th December, 1992.

The unfortunate legacy of Ireland's public expenditure binge in the 1970s was longer-lived than any positive economic stimulus. By 1992 the servicing of debt still consumed 71 per cent of all Irish income tax revenue. The majority of Irish economists now concede that this debt servicing raised the burden of Irish tax, altered the composition of government spending away from improving the nation's social welfare and adversely affected the balance of payments.⁴¹

On the revenue side, European integration may have temporarily helped reduce the tendency of Ireland's profligate politicians to spend more than the nation could afford.

³⁹ Ibid, p.12.

⁴⁰ The reduction in government borrowing that took place 1986-1992 was equivalent to a 6 Irish pence cut in the standard income tax rate and 10 p on the top rate. Had Irish debt relative to national income not been reduced then by 1992 the standard tax rate would have been 33 per cent and the top rate 58 per cent. Alternatively, health spending would have been 45 per cent lower or social welfare 20 per cent lower.

On the other hand, however, the existence of additional funds from Brussels may not have mitigated this bad habit. In terms of the effect on public spending, the character of local government changed in some senses as a response to European factors. City and county managers in Ireland's local government have seen their role transformed as responsibility for developmental and environmental protection and regional planning for disbursement of EC structural funding have become part of their daily function.⁴² The changing scale of EU support to the Irish Republic is shown below in Table 2.2.3 below.

Table 2.2.3 Gross and Net Receipts from EU Budget, Republic of Ireland, 1978-93.

Year	Receipts (IR£M)	Contributions to EU budget (IR£M)	Net Receipts (IR £M)
1978	410	46	364
1981	507	105	402
1984	867	203	664
1987	1100	255	845
1990	1741	283	1458
1993	2245	453	1792

Source: Department of Foreign Affairs, Dublin, Simpson, 'Fiscal realities: The Degrees of Difference', p.89

Table 2.2.3 of course does not tell the whole story of the importance of the EU to the national economic picture. The relative impact of European funds can be illustrated in terms of the equivalent proportionate addition to total government revenue. In 1993, the receipts of IR£2,245 billion from the European Union represented 22 per cent of Ireland's total Government Revenue and 7 per cent of Irish GNP. In other words, these additional European funds were the equivalent of the whole interest bill on the outstanding national debt.⁴³

In the early 1990s, Ireland's budgetary health remained not only weak by the all too weak standards of the European Commission/ Union, but it also was skewed away from

⁴¹ De Buileir and Thornhill, *EMU and Irish Fiscal Policy*, p.10.

⁴² Hussey, *Ireland Today*, p.99.

⁴³ Simpson, 'Fiscal Realities: The Degrees of Difference', p.90.

the norm in terms of where tax revenue was derived from. Table 2.2.4 below illustrates how Ireland's tax structures compared with the EC average in 1990. As the table below suggests, Ireland relied little on social security contributions relative to other European economies. To a certain extent this feature was unavoidable given Ireland's poor record on employment creation: without faster job creation the tax base could not be increased. Given that Ireland's income per capita remained low by European standards, it was more surprising that by 1990 taxes on personal income were relatively high. This unfortunate state of affairs is probably largely explained by the coexistence of a low stream of corporate tax revenue and the absence of any major local property tax. The low income per capita also coexisted with a relatively high reliance on specific consumption taxes (excises). This combination of low median incomes, high unemployment and high consumption taxes not only was inefficient, but it was inequitable too, it tended to be regressive in its impact on income distribution.

Table 2.2.4 Irish and EC Tax Structures as % of GDP 1990.

	Ireland	EC Average
<i>Total Tax Burden</i>	37.2	40.8
<i>Taxes on Income and Profits</i>	13.7	14.1
<i>Of which</i>		
<i>Taxes on Personnel Income</i>	11.9	10.8
<i>Taxes on Corporate Income</i>	1.8	3.1
<i>Social Security Contributions</i>	5.5	11.5
<i>Taxes on Property</i>	1.7	1.9
<i>VAT</i>	7.7	7.3
<i>Excise Type Taxes</i>	7.5	4.8

Source: De Buitelir, *EMU and Irish Fiscal Policy*, p.21.

Table 2.2.5 below illustrates in more detail the trends in Irish Corporation tax relative to the rest of Europe. Despite the difficulties inherent in estimating comparative corporation taxes it can still be noted that the trends in such taxation were upward between 1975 and 1990. The underlying cause of the growth of corporate taxation may have been increased profitability in the 1980s as the worst effects of the 1970s oil shocks wore off and liberalisation allowed corporations to shift production to lower cost centres.

Table 2.2.5 Taxes on Corporate Income as a % of GDP, 1975-90.

Country	1975	1990
<i>Belgium</i>	3.0	2.9
<i>Denmark</i>	1.3	1.6
<i>France</i>	1.9	2.3
<i>Germany</i>	1.6	1.8
<i>Greece</i>	0.9	2.1
<i>Ireland</i>	1.5	1.8
<i>Italy</i>	1.7	3.9
<i>Luxembourg</i>	6.2	8.2
<i>Netherlands</i>	3.4	3.4
<i>Portugal</i>	n.a	2.6
<i>Spain</i>	1.3	3.0
<i>UK</i>	2.4	4.0
<i>Average</i>	2.3	3.1

Source: De Butleir and Thornhill, *EMU and Irish Fiscal Policy*, p.29.

2.3. The Celtic Tiger and After: Ireland's Fiscal Record 1992 to the Present

Table 2.3.1. Economic and Budgetary Indicators.

	1997	1998	1999	2000	2001	2002
<i>GNP</i>	9.5	8.2	8.8	10.7	4.6	1.8
<i>GDP</i>	10.9	8.8	11.1	11.0	5.7	4.5
<i>General Gov. Balance (%GDP)</i>	1.2	2.4	2.1	4.4	1.6	-0.3
<i>General Gov. Debt (%GDP)</i>	65.0	54.9	49.3	39.3	36.7	34.1

Note % Volume Change (except where otherwise stated)

Source: IBEC, *Economic Trends: Budget 2003 Analysis*, December 2002.

Table 2.3.1 above illustrates that Ireland's economic roller coaster is now moving into a dip. This downturn (whatever its final scale) will have major implications for reforming the tax system. In 2000 Ireland marked the millennium by attaining the fastest GDP growth of anywhere in the world and by 2001 Ireland was still top of the OECD growth league table.⁴⁴ Yet by the time of December's budget all talk of a Celtic Tiger had receded and been replaced by a more austere fiscal environment. The budget announced on December 4th 2002 was conducted against the backdrop of economists debating the relative probability of a "soft landing" versus a "hard landing".⁴⁵ As things turned out the budget did not tackle the politically sensitive issue of public sector pay and conditions (public sector employment in Ireland increased by 50,000 in the five years preceding the budget) while it did focus on ensuring a soft landing. The budget failed to raise tax credits in line with wage growth, and this will eventually contribute to an increase in the burden of taxation. A shift towards indirect taxation in the budget will also curb future consumption. The budget unfortunately was simultaneously somewhat unfriendly towards business: changes in capital allowances reduced the incentive to invest, as did the increased stamp duty on investment property.⁴⁶ Of most direct relevance to this study, the budget made no moves to decentralise the tax base. In fact the option was not even mentioned in the budget speech. This silence reflects public opinion on the issue, a topic that will be elaborated on in section 5.

In this section the intention is to briefly outline how Ireland's public finances were transformed by the boom of the 1990s and to also note that the surge in economic growth was not accompanied by a reduction in Ireland's high level of fiscal centralisation. This should not be understood as indicating that fiscal decentralisation would not have boosted the Irish economy to an even greater degree. Instead it is worth noting the causes, consequences and extent of the boom because the Celtic Tiger was accompanied by a

⁴⁴ Ó Gráda, 'Is the Celtic Tiger a Paper Tiger?', p.51.

⁴⁵ Ireland's economics ministry, the Department of Finance for instance forecasts that GNP growth will average 2.5% for the period 2002-2005. This is substantially below the rates of GNP growth Ireland experienced in the 1990s.

⁴⁶ Ernst & Young, *The Sunday Business Post*, p.3.

swollen housing market that made introducing property taxes (or for that matter a return to rates) a politically impossible course of action. The general consensus of the large literature on the Celtic Tiger is that inflows of foreign investment into Ireland during the 1990s transformed the supply-side. It is moreover worth noting that the main engine for attracting inward investment into the Irish Republic has undoubtedly been the generous tax and subsidy package offered to potential inward investors. By most accounts it is one of the most generous industrial incentive packages in Western Europe.⁴⁷

In particular the 10 per cent rate of corporation tax (now increased to 12.5 per cent) has proved especially important in attracting inflows of foreign investment. Furthermore, relatively generous grant incentives, particularly for capital investment, have also been a hugely important part of the story of Ireland's rapidly changing economic fortunes. On the other hand, there has been some reduction in the scale and scope of grants since the 1980s. Assessing the cost of these incentives is difficult to say the least. However, grants totalling IR£430 million were paid to new inward investment projects in the 1980s. In addition, the estimated tax relief for all manufacturing industry located in Ireland 1991 alone amounted to IR£600 million. It is important to note that the vast bulk of this public money went to new inward investment projects.⁴⁸ Despite this consensus there are a number of competing perspectives on the exact mix of factors that are needed to explain the rise and fall of the Celtic Tiger. It is worth outlining these explanations because the 'Celtic Tiger' phenomenon has attracted a huge general interest in the applied economics literature. Yet it is also worth illuminating these competing perspectives because they have different implications for the direction of fiscal centralisation and decentralisation.

The popular media view of the Tiger has been that it was the product of wise interventions by politicians and civil servants. In addition, it is generally believed that Ireland had a uniquely well-qualified labour force that made it a prime location for inward investment. In this popular view of recent economic history, the introduction of free secondary education in 1967 is seen as the prime long-run determinant of economic development. MacSharry and White's best selling account *The Making of the Celtic Tiger*

⁴⁷ Hamilton, 'Inward Investment: Getting the Best From Foreign Capital', p.213.

⁴⁸ Ibid p.214.

exemplifies this popular view of the sources of Ireland's economic renaissance.⁴⁹ In their discussion Ireland's economic miracle was the result of successive governments taking a single-minded approach to improving macroeconomic performance by investing in education.⁵⁰ It has been consequently suggested that government spending on education finally paid off in the 1990s. Yet Ireland's educational record looks less impressive when compared against the education systems of other countries. The International Adult Literacy Test (IALS), which focuses on the literacy of schoolchildren old enough to be in the labour force placed Ireland as being ahead of only Portugal of the ten EU economies included.⁵¹ In other words, human capital inspired by strategic and wise government intervention seems implausible as a convincing explanation of Ireland's economic turnaround.

A second perspective on the phenomena of the growth turnaround is encapsulated by Ó Gráda's claim that it was a once and for all surge in growth rates associated with Ireland converging on its long run income level.⁵² He suggested that Ireland for the period 1950-1998 grew just as fast as an economy with its 1950 income level might have been expected. Thus just as Ireland had under-performed its expected long-run growth rates before the 1990s so it exceeded these rates in the 1990s.⁵³ Honohan and Walsh provide a similar perspective on the issue.⁵⁴ The current downturn in economic growth then represents a reversion to the mean rather than a genuine cause for concern. The earlier mistakes that prevented Ireland converging earlier were maintaining protectionism and excessive public expenditure. The long-run stimulants to growth included: an attractive set of industrial subsidies, an underemployed labour force, a stock of emigrants willing to return, ample energy supplies and a developed administrative and transportation infrastructure.⁵⁵ The bulge of inward investment in the 1980s and the fiscal retrenchment of the period created a new economic environment that allowed a boom to emerge that allowed Ireland to make up lost ground.⁵⁶ The implications for the dynamics

⁴⁹ MacSharry and White, *The Making of the Celtic Tiger: the Inside Story of Ireland's Boom Economy*.

⁵⁰ Ibid, p.363.

⁵¹ Ó Gráda, 'Is the Celtic Tiger a Paper Tiger', p.54.

⁵² Ibid.

⁵³ Ibid, p.52.

⁵⁴ Honohan and Walsh, 'Catching Up With the Leaders'.

⁵⁵ Ó Gráda, 'Is the Celtic Tiger a Paper Tiger?', p.53.

⁵⁶ Ibid, p.60.

of fiscal centralisation of this analysis would be that the window for opportunity in introducing tax reform can most easily be achieved when the economy's growth is slowing. Such a situation allows reform to occur without inflated asset prices making it politically problematic.

A microeconomic perspective on the economic record between 1992 and the present comes from Gallagher, Doyle and O'Leary.⁵⁷ Influenced by Porter's Diamond analysis of competitive advantage they examined the private and public sectors related roles in stimulating competitive advantages. Gallagher, Doyle and O'Leary found that foreign owned firms concentrated in the electronics, pharmaceuticals and financial service sectors were disproportionately responsible for Ireland's manufacturing boom.⁵⁸ They additionally noted that Ireland in the last two decades has had greater numbers at or around the school leaving age than has been the case in other EU members. This quantitative demographic dividend when combined with improved educational standards was according to Gallagher, Doyle and O'Leary vital to sustaining the boom, but they note this boost to the labour supply will not be sustained. Overall they suggest that sustaining future economic growth at rates of 5 per cent or higher will require that a menu of micro and macroeconomic policies be implemented to prevent obstacles to future growth emerging. The avoidance of supply-side bottlenecks and the continued attraction of inward investment are areas of most concern to these authors.⁵⁹ In terms of the implications for fiscal centralisation Gallagher, Doyle and O'Leary's analysis implies that the extent of new household formation, as the school leavers of the 1990s become homebuyers of the next decade, will shape the potential for fiscal decentralisation. As home ownership grows so the designers of potential decentralised tax systems must note the political implications of even greater house ownership.

3. THE CURRENT STATE OF FISCAL DECENTRALISATION IN THE REPUBLIC OF IRELAND

3.1. The Position of Fiscal Decentralisation in 1992

⁵⁷ Gallagher, Doyle and O'Leary, 'Creating the Celtic Tiger and Sustaining Economic Growth: a Business Perspective'.

⁵⁸ Ibid, p.77.

⁵⁹ Ibid, p.78.

The distinction introduced into the 1976 Layfield committee on local government finance in the UK is relevant to studying fiscal decentralisation in Ireland. The Layfield committee distinguished between local government finance and responsibilities that were localist and centralist in orientation. The former approach to fiscal policy gives local authorities tax raising and spending powers while in the latter central government retains these levers and fiscal policy remains centralised. The Layfield committee argued that there should be a close link between the degree of responsibilities for expenditure that a local authority enjoyed and the responsibility for tax raising. In other words, the report suggested that a government opting for a localist approach should raise the proportion of local spending financed by local taxes to around half of total revenue requirements (by means of a local income tax). A centralist approach would correspondingly imply that local spending should be centrally financed with a residual property tax for the rest.⁶⁰ In the localist approach, these authorities themselves will raise the bulk of local government expenditure. In stark contrast, the centralist form would imply that most of the money would come from central government grants.⁶¹ In the Irish case centralism in both tax raising and spending was very much in force at the time of the emergence of the Single European Market in 1992.⁶² By 1992 it had long been recognised that Ireland's system of local government had very limited financial autonomy. The one major power that councillors enjoyed in the early 1990s was not even economic, instead their one major power was political. They constituted the majority of voters for the Seanad Éireann (Irish senate).⁶³

By the early 1990s specific grants from the central exchequer accounted for a full 80 per cent of capital expenditure in local authorities. The remaining share of revenues came from house-loan repayments, water and service charges, refuse-collection charges, planning applications and employees pension contributions. In addition to this group rates on commercial property should be included.⁶⁴ In the early 1990s on the expenditure side this revenue found its way into eight broad programmes outlined in Table 3.1.1 below.

⁶⁰ King, 'Local Taxation', pp.103-104.

⁶¹ Ibid, p.106.

⁶² Ibid, p.103

⁶³ Hussey, *Ireland Today*, p.104.

⁶⁴ Ibid, p.99.

Well over half went to programmes 1 and 2, which were areas controlled by central government. By the early 1990s the segments for which no real local autonomy included significant areas of Irish economy and society such as: urban road transport, ports, airports, agriculture, forestry, fishing, hunting, electricity, commerce, tourism, security, police, justice, education, hospitals, personal health and family welfare services. The functions that local authorities did carry out in these areas were in any case very strictly controlled by central government.⁶⁵

Table 3.1.1 Local Government Expenditure by Sector (programme group) 1992.

Programme Group	Expenditure (IR£)	Percentage (%)
<i>1 Housing</i>	231,120,659	20.09
<i>2 Roads and Traffic</i>	443,773,515	34.94
<i>3 Water Supply and Sewage</i>	122,232,734	10.62
<i>4 Development Plans</i>	30,743,810	2.6
<i>5 Environmental Protection</i>	141,780,986	12.32
<i>6 Recreation and Amenity</i>	97,853,876	8.50
<i>7 Education</i>	62,047,668	5.39
<i>8 Miscellaneous</i>	62,820,371	5.47
Total	1,192,373,619	100

Source: Hussey, *Ireland Today*, p.100.

This very political, financial and administrative weakness of local government has ensured that the issue of fiscal decentralisation has not been one much seriously studied by Irish economists, economic and political historians or even for that matter political scientists. Given the paucity of the literature therefore McNamara's 1993 article on the degree of centralisation in Irish constitutional structures provides a good starting point to developing the recent history of fiscal centralisation in Ireland and a discussion of how the current state of affairs can be altered.⁶⁶ For McNamara, Ireland's 'non-participatory' forms of local and national democracy (with its attendant consequences for fiscal policy) were to be contrasted with the Swedish example. McNamara argued that elected councillors for local government had little real power, and apart from a few charges

⁶⁵ Ibid, p.100.

⁶⁶ McNamara, 'Government without Citizens'.

levied by the Dublin Corporation in the early 1990s, there consequently was little sense in describing them as power brokers.⁶⁷ Despite public criticism of the propensity with which Irish councillors engage in all expenses paid 'fact finding trips' there is little money to be made from serving as a councillor. The usual range of motivations that have been suggested include: personal satisfaction from service to the community, enjoyment of minimal power and prestige and creating a public platform from which to build a political career.⁶⁸ Another element of Irish public life has been that these councillors had little input from the public other than at election times.

Yet according to McNamara this centralised state of affairs was not how legally Irish local government was formally constituted. McNamara outlined the actual formal legal position as it stood in 1992 as follows:

Local Government Act, 1941, Part VIII

Local Government Act, 1955, Part V

Local Government (Planning and Development) Act, 1963, Section 14

Local Government Act, 1991.

The first two Acts mentioned above allowed for the creation of approved local councils (ALCs). A local council established 'for furthering the general social and economic interests' of its inhabitants could be recognised by a county council as an ALC. Moreover, counties had the legal power to delegate to these ALCs any of their own powers and duties that they considered would be better regulated or managed at the lower level.⁶⁹ According to McNamara the failure of Ireland's local government system to evolve in the manner described by these Acts was due to an unfortunate combination of public political apathy and ignorance.⁷⁰

The 1991 Act strengthened the formal powers of councils in Ireland. In particular the 1991 Act granted local authorities representational and competence powers. Under the banner of representational powers the local authority was allowed to represent the

⁶⁷ Ibid, p.309.

⁶⁸ Hussey, *Ireland Today*, p.96.

⁶⁹ McNamara, 'Government Without Citizens', p.309.

⁷⁰ Ibid, p. 310

interests of its constituents as it saw fit. The general competence provision further ensured that a local authority could in the language of the Act, 'engage in such activities in accordance with the law...as it considers necessary or desirable to promote the interests of the local community'. However, a local authority could not replicate an activity already being done by some other public body.⁷¹ Likewise, the 1991 Act further extended the ability of local authority to expand its powers. Under the 1991 Act the central government could in addition transfer any 'function of a Minister of Government...that in the opinion of the government, could be effectively performed by local authorities'.⁷²

McNamara categorised the theoretical existence of formal legal powers strengthening the power of local authorities without the willingness or ability to implement these powers, with the Swedish case. He noted that in Sweden there was a great diversity in how *Kommunes* (Sweden's basic unit of local government) were actually organised. Yet, despite this diversity, the common denominator was that there was great deal more public participation in the structures of local government than was the case in Ireland.⁷³ Apart from a brief mention of redirecting the educational budget towards civics, McNamara unfortunately did not discuss the role of taxation and spending (at either national or local level) in his advocacy of a less 'British' system of local government. The possible linkages between a decentralised system of taxation and greater autonomy in spending decisions are issues that his article does not discuss. In other words, McNamara never seriously considered the economic elements of why Swedes were more likely to participate in local government than people in Ireland. These are serious drawbacks of McNamara's seminal and important article, especially when viewed from a perspective of examining the possibilities for fiscal decentralisation within the Irish Republic. These kind of issues will be examined more fully in the remaining sections of the report.

3.2. The Position of Fiscal Decentralisation in 2002/3

⁷¹ Ibid, p.310.

⁷² Ibid, p.311.

⁷³ Ibid, p.311.

The political economy of fiscal decentralisation in 2002/3 is covered in more detail in section 5. However for the moment it is suffice to state that there has been no meaningful shift towards restoring local government finance in Ireland. Fiscal centralisation remains the politically rooted norm. Table 3.2.1 below uses the Irish Department of Finance's own figures. It demonstrates that because there is no taxation below the level of at the local level, so adjusting the future tax base to forecast expenditure needs will ensure that VAT and income tax remain the major sources of tax revenue in Ireland. The raising of the 12.5% rate of VAT in the last budget to 13.5% will further add to existing price increases and this will tend to reduce international competitiveness.

Table 3.2.1. Current Tax Receipts 2002 to 2005.

	<i>2002 Outturn (Euros millions)</i>	<i>Estimated 2003 Post-Budget estimate (Euros millions)</i>	<i>2004 Projection</i>	<i>2005 Projection</i>
<i>Customs</i>	133	141	144	147
<i>Excise Duties</i>	4,411	4,810	5,144	5,477
<i>Capital Taxes</i>	730	1,070	948	998
<i>Stamp Duties</i>	1,140	1,419	1,544	1,631
<i>Income Tax</i>	9,106	9,307	9,947	10,615
<i>Corporation Tax</i>	4,925	5,068	5,255	57,742
<i>Value Added Tax</i>	8,870	9,826	10,597	11,341
<i>Agricultural Levies</i>	21	5	5	6
<i>Tax Receipts</i>	29,336	31,646	33,584	
<i>Non-Tax Receipts</i>	2,173	1,003	640	
<i>Total Current Receipts</i>	31,509	32,649	34,224	

Source: Department of Finance, Dublin.

4. EU TAX HARMONISATION AND ITS IMPLICATIONS FOR THE IRISH REPUBLIC

4.1. Tax harmonisation and Inward Investment

Tax harmonisation has found its way into the textbooks on European economic integration. This literature has a range of important implications for the study of the economic activity in Ireland. Harmonisation of tax is often presented in the literature as removing obstacles associated with a diversity of tax rates.⁷⁴ It is suggested for instance that nations with the lowest tax rates will not always be the nations with the most efficient producers.⁷⁵ A more specific textbook argument suggested for introducing tax harmonisation into the European Union (EU) is to prevent the adoption of "beggar thy neighbour" tax policies. It has been suggested that the downward trend in taxation since the 1980s and 90s provides evidence that "beggar thy neighbour" fiscal policies will result in decreased revenues.⁷⁶ Such analyses of EU taxation ignore the possibility that lower tax rates can act as a stimulus to productive effort and tend to boost revenues accordingly (the so-called Laffer effect). What is more, the tax cuts that did occur in the 1980s and 1990s may have been due to a turn in the political business cycle rather than representing a genuine Damascus conversion to economic liberalism by previous advocates of big government. It is notable that the Ruding Committee, the committee of experts appointed to investigate the level of corporation taxation in the then EC ahead of creating the Single Market, found no definite evidence that corporate taxation was subject to "beggar thy neighbour effects".⁷⁷ What the Ruding Committee did find however was that there is some evidence that difference in corporation taxes 'distorted' investment.⁷⁸ In fact during the period 1965 to 1992 the overall trend in European corporate tax rates was upward.⁷⁹ The Ruding Committee's recommendation of a minimum 30 per cent rate of corporate tax was therefore of direct relevance to Ireland.

Harmonisation of tax rates has also been suggested as a remedy to the alleged problems associated with transfer pricing. It is suggested that harmonising taxes will prevent corporations showing costs in those EU member states that offer grant aid, while it is also claimed that harmonising taxes will also prevent profits being declared in low-

⁷⁴ Mulreany, 'Taxation: Ireland and the New Europe', p.16.

⁷⁵ Ibid, p.16.

⁷⁶ De Buitelir and Thornhill, *EMU and Irish Fiscal Policy*, p.20.

⁷⁷ Ibid, p.20.

⁷⁸ Mulreany, 'Taxation: Ireland and the New Europe', p.14.

⁷⁹ De Buitelir and Thornhill, *EMU and Irish Fiscal Policy*, p.20.

tax member states.⁸⁰ Proponents of tax harmonisation therefore suggest that the existence of transfer prices distorts the recording of output and profits and this implies that recorded productivity levels can be illusory. The possible elimination of transfer pricing associated with harmonising taxes raises important issues in the Irish case. Ireland since the 1970s has had a strong potential for transfer pricing because of its low corporate tax rate, dependence on inward investment and the extent to which affiliates in Ireland either buy from or sell to foreign affiliates within the same firm. Advocates of tax harmonisation have claimed that Ireland's underlying physical productivity and product quality position have for instance been camouflaged by foreign firms reliance on transfer pricing in relation to their Irish operations.⁸¹ By way of illustration, it is asserted that transfer pricing has tended to inflate the level of value added in Ireland.⁸² Nevertheless, the statistical evidence from Ireland suggests that transfer pricing is not a substantial enough a problem to require the drastic measure of harmonising tax rates.

Hitchen and Birnie's empirical research has examined the extent of transfer pricing in their work on the determinant and levels of Ireland's international competitiveness. Hitchens and Birnie however did not discover any quantitative backing for the claim that transfer pricing was responsible for Ireland's productivity advantages.⁸³ In other words, Hitchens and Birnie's analysis suggested that high Irish productivity was not an illusion due to transfer pricing.⁸⁴ This evidence consequently suggests that the supposed productivity and efficiency benefits of tax harmonisation to Ireland cannot rest on eliminating transfer pricing as such accounting factors are not hiding an underlying productivity gap.

Additionally, the textbooks do recognise that potential costs are also associated with tax harmonisation. These costs may be relevant to an analysis of the Irish tax system. The major costs identified include reduced sovereignty. Likewise, the scope for attracting inward investment will be decreased if states have less choice in setting levels of corporation tax. By way of illustration, any future harmonisation of corporate taxation

⁸⁰ Mulreany, 'Taxation', p.16.

⁸¹ Foley, 'Interpreting Output Data on Overseas Industry', Hitchens and Birnie, *The Competitiveness of Industry in Ireland*, p.68.

⁸² Foley, 'Interpreting Output Data on Overseas Industry'.

⁸³ Hitchens and Birnie, *The Competitiveness of Industry in Ireland*, pp.68-78.

⁸⁴ *Ibid*, p.75.

would occur at a level above 12.5 per cent, so for Ireland a doubling or trebling of its corporate tax rate (because of tax harmonisation) would provide a major setback to continued economic growth. As the Celtic Tiger era comes to an end and as major industrial economies are starting to show signs of recession, harmonising taxes in an upward direction could consequently jeopardise Ireland's hopes of securing a substantial share of a dwindling range of inward investment projects. In the case of the Republic of Ireland this potential cost of tax harmonisation outweighs the highly marginal and debatable benefits associated with eliminating transfer pricing. A major political obstacle to any Irish government accepting harmonisation of taxes is thus the justified fear that higher corporate tax rates will damage the ability of Ireland to sustain long-term economic growth.

5. POLITICAL AND PUBLIC OPINION

5.1. Fiscal Decentralisation as a Public Policy Option

A few isolated academics have called for the introduction of some sort of local taxation in Ireland. Donal De Buitléir, the leading, perhaps because he is the only, economic expert on the structure of Irish taxation, has been an enthusiastic supporter of fiscal decentralisation.⁸⁵ The eminent political scientist Tom Garvin has also taken this view. Garvin has nevertheless suggested that the centralisation of tax raising and spending powers has burdened Ireland's national government with the task of cycling money around the country in response to lobbying and electoral pressures rather than social need.⁸⁶ It is no coincidence that in a 1993 survey of the state of Ireland's fiscal system De Buitléir was also deeply pessimistic about the political willingness to implement a proper system of local government finance.

'The main problem with property taxation is the political unwillingness to introduce it [into Ireland]. While from a technical tax point of view, a property tax may be the best solution to the problem of reducing tax rates to competitive levels while remaining within reasonable constraints on public borrowing and avoiding

⁸⁵ Garvin, 'Democracy in Ireland'.

⁸⁶ Ibid, p.53.

excessive reductions in public spending, it is very difficult to see how politicians can be persuaded to move on it'.⁸⁷

Likewise, the report by De Buitelir, written with Thornhill, for the Dublin based Institute for European Affairs in the same year, was also deeply pessimistic about any attempt to decentralise Ireland's system of taxation and expenditure.⁸⁸ In that report they advocated a restoration of property tax because it would allow for income and consumption tax reductions and stable public expenditure levels while simultaneously keeping Ireland within the Maastricht Treaty obligations on public borrowing. It is worth noting in this regard that De Buitelir and Thornhill mentioned the problems associated with Great Britain's short-lived poll tax. In order to assuage public opposition to the reintroduction of a taxation levied on owner occupied residential housing the authors suggested that income tax reductions should be introduced simultaneously with the creation of a local property tax. The authors bemoaned that local taxation would only be reintroduced if Ireland's growth rate for the remainder of the decade was stagnant.⁸⁹

Of course we have seen earlier in this study that the 'Celtic Tiger' phenomena ensured that Ireland's economy soared for the remainder of the 1990s. With this booming housing market so the hopes for a restored local taxation based on property values receded. At the time of writing in January 2003 the Irish economy has slowed from the peak of the wide economic and narrow housing boom. It is thus worth therefore repeating that the 1993 report suggested that sluggish economic growth in Ireland would make a return of property taxation more likely, albeit if only marginally. If this is the case, then the improved prospects for fiscal decentralisation may be one of the few isolated benefits of Ireland's current economic downturn. Yet just as Irish governments will cling to low rates of corporate tax, so they will also oppose any reduction in their centralised power of controlling taxing and spending decisions.

⁸⁷ De Buitelir, 'Taxation in Ireland', p.183.

⁸⁸ De Buitelir and Thornhill, *EMU and Irish Fiscal Policy*, p.56

⁸⁹ *Ibid*, p.57.

5.2. The Views of Irish Politicians and Public Opinion on Restoring Rates or Creating a New Local Taxation

As should be clear by now, Ireland has very populist political system. That is to say it is a political system in which political leaders and the electorate are unusually vulnerable to influence by each other.⁹⁰ The Irish population is very close to its leaders. For instance, Bertie Aherne, the current Irish Prime Minister, regularly drinks in the pubs within his north Dublin constituency. This very closeness means that both political leaders and representatives are personally known to a degree that is unknown in larger nation states. This situation ensures that Irish politicians are abnormally open to pressure from their electors.⁹¹ The structure of the Irish tax system hence reflects public opinion, even if it can be demonstrated that the fiscal framework is unusually adverse in its macroeconomic impact. The positions of Irish politicians outlined below are hence reflective of public opinion. There has for instance been no outpouring of public opinion since the December budget calling for a more decentralised system of taxation. The *Irish Times* budget survey for 2002 a wide range of opinions could be detected on reforming the Irish fiscal system voters and business leaders. There was no call for a more decentralised system of taxation within Ireland. However, as the economy languishes and the housing market begins to stagnate, so a more decentralised system of taxation may become politically possible as public opinion and consequently the nation's political leadership starts to re-evaluate the situation.

The dominant school of thought on tax harmonisation and how it relates to Ireland, amongst politicians, can be found in former Prime Minister, Albert Reynolds comments on the Irish tax system.⁹² Writing in 1991, he suggested it was inevitable that 'moves towards economic and monetary union will inevitably mean that more of our tax code will come under review'.⁹³ This Reynolds view implies that tax harmonisation is an inevitable consequence of European economic integration. However, two further features are of note. Reynolds however definitely drew the line at harmonisation of Irish

⁹⁰ Garvin, 'Democracy in Ireland', p.44.

⁹¹ Ibid, p.44.

⁹² He wrote the comments in 1991 while still Irish Finance Minister.

⁹³ Reynolds, 'Introduction', p.1.

corporation tax, which suggests that if Ireland got its way, admittedly a big if, then the onus of future tax harmonisation will fall on VAT and excise duties.⁹⁴ Furthermore, Reynolds believed that tax harmonisation will eventually occur at a high rate of tax because of voters desire for an interventionist government and extensive provision of public services.⁹⁵ A reintroduced Irish rates or new local income tax would of course allow some cuts to be made in the rates of VAT and excise duties to be made. Politically though this course of action this may be difficult to implement, not just because of the political implications of altering local government finance, but also because the existing high rates of VAT and excise duties on cigarettes and alcohol have large health implications. So with harmonisation of income tax not yet on the cards, and the alternatives involving reduced rates of VAT having considerable political difficulties there will be profound political implications associated with any further shifts towards tax harmonisation.

In terms of the views of Ireland's major political parties, Fianna Fáil, the major party in Ireland's ruling coalition, is interested in decentralisation of government offices, inward investment and other amenities as party of its National Spatial Strategy. However, there is currently no mention in the party's web-site of the current government introducing a more decentralised system of public finance within Ireland. The party has instead repeatedly reiterated Albert Reynold's defence of Ireland's low rate of corporation tax. As has been already demonstrated, this defence of Ireland's corporate tax system is linked to the view that Ireland's economic growth has largely been the result of inward investment projects being attracted by a low tax environment.⁹⁶ For example, the budget speech in December 2002 made no mention of altering Ireland's tax base towards a more decentralised system. The governing coalition's junior partner, the Progressive Democrats, unsurprisingly makes no promises to create a more decentralised system of taxation within Ireland.⁹⁷ In terms of the two main opposition parties Fine Gael and the Irish Labour Party there is also silence on the issue of reforming the Irish tax system. Neither of these parties electoral manifesto discussed, much less advocated, the

⁹⁴ Ibid, p.2.

⁹⁵ Ibid, p.3.

⁹⁶ <http://www.fiannafail.ie>.

⁹⁷ <http://www.progressivedemocrats.ie>

possibility of creating local taxation in Ireland. Of course all the parties are united (and in line with public opinion) in defending Ireland's low rate of corporation tax.

6. THE INSTITUTIONAL ECONOMICS AND CONSTITUTIONAL POLITICAL ECONOMY OF IRISH FISCAL POLICY

6.1. Introducing Some Theoretical Considerations

In section 3 of this report the Layfield distinction between localist and centralist approaches was introduced. It was suggested that the former approach implied a high degree of fiscal decentralisation while the latter implied a low degree. Ireland at independence and certainly since 1978 has opted for the latter route. However, the Layfield committee's exact reasoning on the institutional and economic merits of both was not pursued in the 1976 report. Nor did the report consider how its findings would relate to the Irish case. One instead needs to look to King's 1993 essay to get some theoretical grasp of these issues.⁹⁸ In brief, King suggested that local governments should either be regarded as agents of the central government and have little tax raising power (as in centralisation) or be regarded as autonomous bodies initiating their own policies and having high degrees of decentralised tax power.⁹⁹ King, having outlined the theoretical features of the two respective approaches, suggested that the centralist emphasis on central government grants funding local authorities (as has been the case in Ireland since abolition of the rates) could only be justified on two main grounds. Firstly, he contended that a centralist approach would make sense because central government would only become aware of actual local needs if it raised the finance itself. Secondly, King warned that a 'democratic deficit' could occur if voters saw little obvious connection between their payment of local taxes and how those local taxes were eventually allocated. King indicated that the first factor would ensure that central government would take a responsible view if fiscal policy was centralised. He noted that the second factor would

⁹⁸ King, 'Local Taxation'.

⁹⁹ Ibid, p.111.

also ensure that centralisation would prevent political confusion arising amongst voters.¹⁰⁰

King argued that the alternative of promoting fiscal decentralisation implied accepting three main arguments for making a direct linkage between local authority revenue and local taxation.¹⁰¹ First, he observed that allowing a range of local taxes would necessarily involve allowing local authorities to adjust the qualities and quantities of their services in response to the wishes of local communities.¹⁰² Second, King noted that a reliance on receiving grants (under fiscal centralisation) has historically allowed local politicians to spend money unwisely and blame the resulting problems on 'under-funding'. Fiscal decentralisation would not in his view suffer from this disadvantage.¹⁰³ Related to this observation, King additionally speculated that local politicians, bureaucrats and voters would take much greater care with the local public finances if the money had been raised locally rather than the result of a subvention received from the centre.¹⁰⁴

King's paper theorised that the localist or decentralised form of public finance has two main notional advantages of special interest to Irish policy makers. King argued that fiscal decentralisation offered the prospect of choice and variety in public service provision rather than the alternative of standardisation and uniformity offered by a 'monopolist' central government.¹⁰⁵ The choice offered by fiscal decentralisation would, in his view, allow institutional innovation and experimentation in the provision of local public services.¹⁰⁶ Such institutional experimentation, King hypothesised, could involve establishing a variety of competing models in education, law and order, transport and standard of living issues.¹⁰⁷ King nevertheless recognised the importance of public opinion in the process of moving from fiscal centralisation to decentralisation (the topic of past and current Irish public opinion on fiscal decentralisation was discussed in section 5 of this report). He noted also that in some countries (he cited Germany, Japan and

¹⁰⁰ Ibid, p.107.

¹⁰¹ It must be noted that King's arguments in favour of fiscal decentralisation imply that local taxes should be ones where local authorities have some discretion on setting the tax rates.

¹⁰² Ibid, p.107.

¹⁰³ Ibid, p.107.

¹⁰⁴ Ibid, p.107.

¹⁰⁵ Ibid, p.109.

¹⁰⁶ Ibid, p.109.

Austria as examples) such is the political support for uniformity in living conditions and constitutional structures that there would be little electoral advantage in any party proposing diversity in local government services and taxes.¹⁰⁸ Correspondingly only where public opinion readily accepted differences in local government provision between various regional and sub-national areas would political support for fiscal decentralisation be strong enough to allow it to be introduced. In the following parts of section 6 the implications for Ireland of trying to vary the quality of public services according to revenue levels will be discussed in more detail.

6.2. Theoretical Aspects of Fiscal Decentralisation: the Frey-Eichenberger model

Frey and Eichenberger's pioneering work on the structure of European economic integration is worth an extended discussion because their analysis of the institutional economics of public finance has large implications for considering the possible implications for Ireland of restructuring the relationships between governmental units.¹⁰⁹ Their starting point is that while the creation of the Single European Market (SEM) since 1992 has been beneficial to the efficiency of the private sectors within the member states economies, this has not been matched by trends in the public sector. This failure they attribute to an absence of formalising competition between governmental units at all levels and the predominant focus on the harmonisation of standards and taxes that has until now dominated the European economic project.¹¹⁰ The current situation they term All-Purpose Jurisdictions (APJ). Frey and Eichenberger contend that because APJ's relies more than other forms of government on politicians lobbying for ever greater funds, so public expenditure grows faster in the APJ than in other systems of public finance. They suggest that most efficiency problems within the public sector and the related issue of excessive public expenditure growth can be mitigated by the creation of functional overlapping and competing jurisdictions (FOCJ). In short they suggest that these lowest

¹⁰⁷ Ibid, p.109.

¹⁰⁸ Ibid, p. 111.

¹⁰⁹ Frey and Eichenberger, 'FOCJ: Creating a Single European Market for Governments'.

level political units, FOCJ, or communities, can be formed, and that the granting of tax levying powers to finance public services would also be part of this process.

The FOCJ framework proposed by Frey and Eichenberger provides four key characteristics for these proposed federal units. Firstly, they are functional, that is to say that the new political units extend over areas defined by the tasks to be fulfilled. Secondly, FOCJ are overlapping, because the corresponding governmental units extend over different geographical areas. Thirdly, such units compete, individuals and/or communities may choose what governmental unit they want to belong to. Furthermore, citizens have democratic rights to express their preferences directly via the ballot box. Finally, these units are legally jurisdictions, the proposed units to be established are governmental, and because these federal units therefore have enforcement power they can, theoretically at least, levy taxes.

Frey and Eichenberger recognise that the potential efficiency benefits attributable to greater competition between levels of government, including cross-border competition, provide economic benefits only by incurring political costs.¹¹¹ It is these costs that they recognise as being the major barrier to reforming the structure of government within the world's developed economies. They suggest that the 'class politique', by which they mean the ruling political and administrative interests, will be opposed to a system of public finance and local democracy that reduces their power relative to the electorate.¹¹² As will be discussed below, and returning to one of the major findings of this report, while this general analysis is correct there are other political and economic issues of relevance to discussing the potential for reforming Ireland's governmental system.

6.3. Implications for Ireland of the of the Frey-Eichenberger Model

Regardless of the economic and political benefits of the FOCJ framework and any other proposal for fiscal decentralisation it is worth considering just how such proposals would relate to fiscal relationships within Ireland and to Ireland's economic relationship with Europe. The politics of these relationships will ultimately determine the plausibility

¹¹⁰ Ibid, p.195.

¹¹¹ Ibid, p.208.

¹¹² Ibid, p.208.

of reforming the institutional settlement in the Republic of Ireland. What is more, these political concerns will determine the possibility that there can be a transition from an APJ into a FOCJ. Frey and Eichenberger's recognition of the political obstacles to creation of a FOCJ are important, but in the Irish case there are specific barriers that must be noted in any discussion of the prospects for fiscal decentralisation. The existence of these domestic hindrances to greater fiscal decentralisation means that a substantial reform of the Irish fiscal system will only be politically possible if it is initiated at the level of the EU. On balance it must be concluded that the political willingness and ability does not exist within Ireland to massively reform its fiscal system in any direction.

In terms of the functionality principle this is based on the economically sound idea that spillovers should be minimised. This requires that a particular public service which benefits a defined geographical area should ultimately be financed by the people who benefit from that service in that area.¹¹³ Of course the reality of the modern Irish economy is that the Greater Dublin region is the engine of the nation's prosperity and has acted as magnet for inward investment and the bulk of the nation's best and brightest workforce. So economically, a functional principle would play well in Dublin as a whole. However, even within Dublin itself there is a huge range of income levels co-existing.¹¹⁴ This 'patchwork of plenty' will continue to complicate any possible reform of local government finance.

In other words, lobbying in the Irish case not only hinders the efficiency of the APJ, it also makes it more difficult to effect the transformation from an APJ into a FOCJ. To illustrate, the co-existence of disparate levels of prosperity would give Irish politicians from poorer wards an electoral incentive to ensure that their constituents would benefit from the wealth of nearby communities. Rather than a Tiebout style 'voting by feet' process undermining this type of institutional reform, the more likely obstacle in the Irish case is a 'dilution by Gerrymandering'. Alas the potential for Irish politicians to manipulate the process should not be underestimated. TD's have for more than eighty years jealously guarded the multi-member constituencies that characterise the Dail (parliament) and more recently it is also clear they are also in favour of retaining the 'dual

¹¹³ Ibid, p.197.

¹¹⁴ Fahey and Williams, 'The Spatial Distribution of Disadvantage in Ireland', pp.232-236.

mandate'. For these kinds of reasons also a move to a more functional form of public finance, will have to come from a European wide reform.

To say the least, Frey and Eichenberger's belief that the threat of secession by jurisdictions will mitigate the power of the central state seems rather fanciful in the Irish case.¹¹⁵ There are no real secessionist groups within the Republic of Ireland, and more importantly neither is there any likelihood of Ireland leaving the EU. Given the popularity of the EU in the country as whole (not least due to the sizeable subventions it has received over the last three decades) there is no prospect of Ireland as a whole exercising this option. One need only reflect on the re-run of the Nice treaty in September 2002 to see just how impossible it is to envisage Ireland in whole or part seceding from the EU. The claim made repeatedly during the campaign by the major political parties that another 'no' vote would politically and economic isolate the Republic struck a resounding cord with the Irish electorate throughout the country. Overall then, the particular form that political economy within Ireland takes ensures that unilateral moves towards institutional and fiscal competition are not likely to come from domestic politicians. Yet ultimately, relying on the EU to initiate a shift towards a more decentralised tax and expenditure system within Ireland may well be a long shot because of the EU's current obsession with harmonisation.

Above the pitfalls of the FOCJ framework in an Irish setting have been outlined. It has been suggested that the political interests within the Irish Republic will make unilateral reform unlikely. However, there are a number of more hopeful indicators that are is worth very briefly mentioning. In particular, what does chime between the Frey and Eichenberger theoretical proposal and the current political economy of Ireland is the reliance of both on referenda. The Irish people are well used to referendums because any proposed constitutional reform needs the support of the electorate if they are to be legally binding. By way of illustration, the two referenda on the Nice treaty was necessary because it affected a range of constitutional issues such as its constitutionally-enshrined neutrality. In addition, the proposal that that FOCJ would allow areas of a given nation state to join the public service provision of another nation state is very reminiscent of O' Mahony's advocacy in 1974 of a more fluid approach to the provision of public services

¹¹⁵ Frey and Eichenberger, 'FOCJ', p.204.

within the island of Ireland. In particular O' Mahony envisaged that the Republic could provide certain public services to parts of Northern Ireland with a nationalist majority.¹¹⁶ While O' Mahony expressly viewed such a proposal as alleviating tensions between Ireland north and south the economic implications would be similar to the FOCJ framework. Nevertheless, any moves in this direction towards an all-Ireland system of decentralised taxing and spending would have very profound and uncertain financial and political costs attached. Again it seems reasonable to conclude that there is neither the political willingness nor ability for Irish politicians to unilaterally move towards this or indeed any other form of decentralisation regardless of the economic benefits.

7. CONCLUSION

Here in the conclusion to this study the above findings in four key areas will be summarised. They are: the current situation regarding fiscal decentralisation, the dynamics of decentralisation, the implications of EU tax harmonisation and an Assessment of Public Opinion.

A) The Current Situation Regarding Fiscal Decentralisation

The current situation is the same as it has been since 1977/78. Ireland has no universal system of taxation at the sub-national level. Consequently, Ireland's tax base is levied and spent at the centre. Ireland's fiscal system is thus heavily centralised and this centralisation (rightly or wrongly) is accepted across the political spectrum as an inevitable part of the economic environment. Any change in the situation will require political willingness and ability that until now has not existed.

B) The Dynamics of Decentralisation and Centralisation

¹¹⁶ Ibid, p.203. O' Mahoney, 'Economics, Government and Law'.

The dynamics of decentralisation and centralisation must be considered over a longer time frame than a decade because the system of local government that currently operates in Ireland was established eight decades ago and because the present system of local government finance was initiated in 1977/78. The continued influence of these historical factors is highly important for understanding the political economy of fiscal centralisation and decentralisation in Ireland. Essentially it must be concluded that Irish politicians have successively reduced the actual day to day powers of local government, regardless of the formal legal position of local councils. Local government because of dual mandate operates as a training ground for aspiring TDs and provides another public platform for actual TDs to communicate their message to the local electorate. This image building factor is highly important in Irish politics because constituencies at general elections are multi-member affairs elected by the single transferable vote (STV) system of proportional representation. Attempts at reforming the finance and structures of relationships between the different layers of government in Ireland have come to naught until now. Central government has clawed back the residual tax and spending powers that local government might once have had. It can be concluded that Ireland has been a highly centralised system of local government over the long-run, and if anything this trend has accelerated in the last two decades.

C) Implications of EU Tax Harmonisation

The European Union is highly popular within Ireland. Membership of the EU has been associated with Ireland's economic convergence on the major industrialised European economies since the 1970s and the more recent Celtic Tiger boom. Irish governments have been diligent in implementing the harmonisation of standards across a whole swathe of areas of Irish economic and social life. European integration, and its associated harmonisation has also enjoyed widespread public and business support. There is a deep awareness within Ireland that the convergence since the 1970s has been inextricably linked to trade liberalisation and the promotion of inward investment. A major component of this trend towards greater openness and growth has been low rates of corporate taxation in Ireland. In response to EU demands, the Irish government has

already been forced to standardise corporation tax for all sectors at 12.5%. The major economic impact of future trends in tax harmonisation would be a further upward movement in Irish corporate tax rates. This is one of the few issues where Irish political and business interests would be hostile to further harmonisation as it is widely felt that it would create a disincentive to invest in Ireland. Allied to this there is now disquiet that QMV may replace unanimity as the determinant of future EU tax policy. There is thus a justified fear that a switch to QMV could become the Trojan horse that would undermine one of business in Ireland's major competitive advantages.

D) Assessment of Public Opinion

Restoration of a more decentralised tax base in Ireland is not yet a major issue in the media or in business circles. The main issues in fiscal policy are mainly concerned with the implications of the budget for sustaining Irish economic growth. The main issue in Irish local government is the extent to which the 'dual mandate' (the practice by which TDs are allowed to also sit as local councillors) helps or hinders creating coherent local politics. The abolition of the rates in the late 1970s was politically popular, so any attempt to restructure the fiscal responsibilities of national and sub-national government will undoubtedly meet determined political resistance. It is noteworthy that almost all the (admittedly very few) academic experts that have investigated the balance between local and central government have advocated restoring some kind of link between local expenditure and taxation. The failure to implement these recommendations, that have often come from governmental reports, can ultimately be attributed to the incentives of senior political and civil service figures. Moving towards a more beneficial form of fiscal relationship between the centre and the localities will require a political will that has not been present within Irish government. On balance, it is probable that only prompting from the EU to initiate fiscal decentralisation will move Ireland in that direction. Of course that scenario remains improbable because the EU itself is currently wedded to the notions of harmonisation and centralisation. If Ireland is to get a more transparent form of fiscal policy that can increase efficiency and improve public services it will require a change at the European level.

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