



How the taxation and welfare systems interact to facilitate employment

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For Information

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Key points

- The objective of increasing employment has many benefits (economic growth, life satisfaction, psychological and physical well-being).
- Decisions about whether to work, and how much to work, vary markedly across cohorts and according to circumstances and, for the same individual, vary at different points in the life cycle.
- The participation rate is a broad measure of labour supply and has shifted significantly for some cohorts over recent decades.
- Measuring the tax wedge is one of the ways of identifying incentives to take up employment – Ireland has the second lowest tax wedge of the 23 EU member states also in the OECD.
- Encouraging employment through the taxation and welfare systems occurs mainly through the channel of financial incentives and services, notwithstanding the range of other factors influencing employment decisions.
- Measures designed to encourage people into employment come with a trade-off that they may also increase complexity, particularly when in-work support or benefit withdrawal are also factors.

Note: Whilst every effort is made to ensure the accuracy of the information contained in this document, this material is provided as a guide only and is not professional advice, including legal advice. It should not be assumed that the guidance is comprehensive and the authors cannot be held responsible for any errors or omissions.

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1. Introduction

The objective of increasing employment is one worth pursuing across a number of dimensions – at the aggregate level, more employment leads to higher economic growth and makes use of productive capacity. At the level of the individual, being in employment affects people’s life satisfaction¹ and their psychological and physical well-being.² An increase in employment can occur by more hours being worked, by successfully aiding those who are unemployed to find work or by facilitating those outside the labour force to join it.³ This paper outlines some preliminary considerations relating to how the taxation and welfare systems affect the level of employment. The issues briefly addressed in this paper can be further developed based on discussions of the Commission on Taxation and Welfare.

Three labour force transitions are of particular interest when considering how the taxation and welfare systems encourages employment:

- unemployed people finding work
- people engaged in part-time work increasing their hours, and
- people joining the labour force⁴.

The discussion of these cohorts covers the financial incentives generated by the two systems (rates of social welfare payments and marginal tax rates) but also secondary benefits, and the provision of public services that facilitate employment. This discussion is informed by the observation that decisions about whether to work, and how much to work, vary markedly across cohorts and according to circumstances and, for the same individual, vary at different points in the life cycle.

The final section of the paper outlines a number of questions the Commission may wish to discuss and probe further relating to the employment topics outlined in this paper. That discussion can also guide the secretariat on future papers to inform further work by the Commission in this area.

¹ Unemployed workers in all 21 participating European countries in the European Social Survey for 2002–2009 show a difference in how they rank their life satisfaction – on a scale of one to ten, employed workers are between 0.5 points and 2.5 points higher. Wulfgramm, M (2014). [Life satisfaction effects of unemployment in Europe: The moderating influence of labour market policy](#); Journal of European Social Policy.

² McKee-Ryan et al (2005). [Psychological and Physical Well-Being During Unemployment: A Meta-Analytic Study](#). Journal of Applied Psychology, 90(1), 53–76.

³ This reference to an increase in employment differs slightly from an increase from the number of people in employment, 2,23 million in Q1 2021, which refers to the number of individuals who have worked at least one hour in the reference week – the scope of this paper extends to increasing hours of employment for those who work part-time.

⁴ The labour force is the sum of working age people whose status is ‘employed’ or ‘unemployed’ – see [ILO](#). For this discussion, joining the labour force refers to those who were previously not in the labour force, and classified as inactive, and does not include inward migration increasing the labour force.

2. Executive summary

The paper sets out some key concepts and preliminary considerations relating to how the taxation and welfare systems affect the level of employment.

The approach to examining employment decisions is to consider, initially, three transitions:

- unemployed people finding work
- people engaged in part-time work increasing their hours, and
- people joining the labour force

A number of measures provide information on labour supply, such as the participation rate, which measures the proportion of the labour force that is either employed or available for work and actively seeking it. This has increased over recent decades, particularly for women. Ireland's prime working age (25-54 years) participation rate is below the EU average but gaining ground. The participation rate for those aged 55-64 is above the EU average - maintaining this rate may become a challenge due to changes in the labour market as the population ages.

The replacement rate is the proportion of earnings from employment that is replaced by a jobseeker payment and it is an indicator of whether people are financially better off in employment. The replacement rate in Ireland is broadly similar to the EU average, particularly when housing benefits are included. Detailed analyses of how jobseeker payments relate to predicted earnings generally find a financial incentive to work for the majority of people.

While part-time work may suit some, it is associated with lower wages. The taxation and welfare system should therefore not hinder progression beyond part-time work and it is noted that policy decisions around income thresholds for benefit withdrawal or higher taxes may have an impact on decisions on increasing hours of employment.

Attracting people outside the labour force refers to people who are neither employed nor unemployed, according to the ILO definition. Reasons for being out of the labour force can include illness, disability, caring responsibilities and retirement. Secondary benefits are a factor in employment decisions where the immediate withdrawal of these benefits could represent a disincentive to take up work. However, many, such as the medical card, are gradually withdrawn over time.

In-work supports are financial supports to people who are in employment but whose income falls below a certain threshold, and are usually calculated on the basis of family size. The design challenge of in-work support is to balance the objectives of support to low-income families while encouraging

greater work intensity and, ultimately, an end to receipt of income supports. Some partial unemployment payments function in a similar way to in-work supports.

Earnings are subject to income tax, USC and PRSI – the combination of these charges gives Ireland one of the most progressive income tax systems within the EU members of the OECD. Tailoring the income tax system to incentivise employment at the lower end of the income distribution can be done through measures such as the PRSI credit but comes with a trade-off of increased complexity.

While the interaction of the taxation and welfare systems are often considered in terms of the financial consideration, engagement with the Public Employment Services, which is compulsory for those in receipt of jobseeker payments, is an important aspect of easing transitions from unemployment or inactivity to employment.

A number of benefits and taxation measures have been designed with cohorts more distant from the labour market in mind. The objective is to provide a minimum level of income where people face particular barriers to the labour market. To facilitate an ongoing connection to work, income disregards typically apply for a portion of earnings.

Although now close to the EU average, the jobless household rate for the working age population decreased more slowly than the unemployment rate over the past ten years. This may have particular relevance if labour market prospects are affected by changes in the household formation process. Jobless households are particularly of concern in the case of children.

3. Labour supply

3.1 Measures of labour supply

3.1.1 Participation rate

The number of people in the labour force tells us how many people are attached to the world of work – either working any number of hours or actively seeking employment and ready to commence (these two categories sum to 2.4 million in Q1 2021).⁵ One broad measure of labour supply is the participation rate, measured using International Labour Organization (ILO) criteria. This is the labour force as a percentage of the working-age population and measures the proportion of an age cohort that is either employed or available for work and actively seeking it.

⁵ The labour force has not changed much as a result of Covid-19, a decrease of 60,800, since Q1 2020, only two weeks of which were affected by public health restrictions.

Participation rates (particularly those disaggregated by age and sex) are the headline indicator of progress towards an inclusive labour market that makes the best use of the available skills. Table 1 shows Ireland's prime working age (25-54 years) participation rate, which is below the EU average but gaining ground. The difference between Ireland and the EU average is primarily driven by a lower female participation rate in the prime working age cohort.

Table 1: Participation rate, %, by age and sex, Ireland and EU average, 2010 and 2020

Year	Ireland, both sexes, 25-54	EU-27/28, both sexes, 25-54	Ireland, women, 25-54	EU-27/28, women, 25-54	Ireland, both sexes, 55-64	EU-27/28, both sexes, 55-64
2010	80.7	85.0	72.6	78.2	55.1	49.5
2020	82.5	85.4	75.7	79.8	64.4	62.9

Source: Eurostat, activity rates by sex, age and citizenship, [lfsq_argan]; values for 2010 are EU-28, values for 2020 are EU-27, average of quarterly values.

The reasons for this are multi-faceted but the higher proportion of women, compared to men, with a third level education over the past 20 years means the financial returns to work in prime working age years, as well as structural changes, may narrow this gap further in the coming decades. Indeed, this is reflected in the increases in the participation rates for women aged 35-44 and 45-54 over the past 20 years, from 63.2% and 52.7%, respectively, in 2000 to 74.3% and 73.1% in 2020. Options to speed its increase include significant changes to child care provision or to increase the extent of individualisation in the taxation and benefit systems, as considered in the NESC report, 'The Future of the Irish Social Welfare System: Participation and Protection'. Quantifying the expected impact on participation would require substantial analytical work but the partial individualisation of the income taxation system in 2000 is estimated to have increased the employment rate of married women by around 5-6 percentage points by changing incentives for secondary earners to work.⁶

⁶ Doorley (2018), [Taxation, Work and Gender Equality in Ireland](#), IZA.

Table 2: Participation rate, %, by age and sex, selected age groups, 2000, 2010 and 2020

Age	15 - 19		19 – 24		25 - 34		35 - 44		45 – 54		55 – 59		60 – 64	
Year	M	F	M	F	M	F	M	F	M	F	M	F	M	F
2000	55.9	41.3	90.2	81.3	93.9	76.3	93.7	63.2	87.7	52.7	74.3	35.3	54.1	19.9
2010	29.1	24.5	81	75.3	89.1	77.95	90.8	69.1	86.4	68.8	73.1	56.3	54.7	33.9
2020	22.2	19.9	65.4	65.4	88.1	75.4	90.2	74.3	87.8	73.1	78.7	63.7	63.8	44.7

Source: [CSO LFS](#)

For the 55-64 age cohort, Ireland's participation rate is higher than the EU average and has increased considerably in the past decade. As the population ages, the challenge will be to create the conditions for continued labour market participation by older age cohorts. This may become more acute if large scale job losses arising from structural changes in the economy are focussed on older workers – the ability of the Public Employment Service to assist them to return to work or retrain will be critical. Two factors that will constrain overall participation rates are worth noting: the structural shift since the Great Recession that sees people aged 15-24 delay labour market entry to increase education levels, and the fact that the high participation rates of 2007 (67.3% in Q3) were boosted by immigration and will be challenging to surpass.⁷

3.1.2 Elasticity of labour supply

Considering labour supply decisions more closely, how responsive people are can be measured by how many more hours people would work if they were to receive a proportional increase in earnings.

Much like the participation rate, the question of how much more people are prepared to work for an increase in the financial return varies by individual and household characteristics. The measure of responsiveness in Ireland decreases across the categories of married women (0.47), single women (0.39), single men (0.33) and married men (0.26). However, this varies considerably across the income distribution, with those who have least income far more responsive.⁸

These measures of responsiveness also vary at the gross and net earnings levels – the latter reflects the influence of the taxation and welfare systems, and the interaction between those systems, in

⁷ See Byrne and O'Brien (2016), [Understanding Irish Labour Force Participation](#), for more on the role of immigration on the participation rate.

⁸ Labour supply elasticities are discussed in Bargain et al; [Comparing labour supply elasticities in Europe and the US: New results](#), 2012, which notes that, for married women, total hour elasticities are higher in Ireland than other most other EU member states, the UK and the US, and higher again for women with children. The measure of responsiveness decreases across the categories of married women (0.47), single women (0.39), single men (0.33) and married men (0.26).

encouraging employment. Measures of elasticity can be used to examine how individuals respond to changes in tax treatment, such as amendments to the income tax rates or bands. A recent Irish study of elasticity of taxable income finds self-assessed taxpayers much more elastic than PAYE taxpayers, and high income taxpayers exceptionally responsive compared to low income taxpayers.⁹

4. Financial incentives

4.1 Jobseekers - unemployed people finding work

Transitions between unemployment and employment are informed by a variety of factors, one of which is the rate of jobseeker payments. The appropriate level of jobseeker payments can be assessed from the adequacy of the expenditure it enables or with regard to some earnings benchmark. For the purposes of the discussion on encouraging employment, this section reviews measures of how jobseeker payments relate to earnings.

Table 3 sets the context for a discussion of financial incentives relating to jobseekers by presenting the maximum weekly rate of jobseeker payments from 2012 to 2018, the 10th percentile of the earnings distribution and the year-on-year percentage change in the consumer price index over the same period. It shows the jobseeker rates for single people correspond to the 10th percentile of the earnings distribution and have grown more slowly than earnings at that point of the earnings distribution.

The rates listed in the table are the maximum personal rates for a single person claiming one of the main two jobseeker payments: Jobseeker's Benefit, which is contingent on pay-related social insurance (PRSI) contributions, time-limited, and not means-tested; and Jobseeker's Allowance, which is means-tested and has no contributory element.

⁹ Similarly, the elasticity of taxable income narrows the focus to the percentage by which individuals increase their income if the net-of-tax rate (i.e. 100% minus their tax rate) increases by 1%. A recent Irish study of elasticity of taxable income finds self-assessed taxpayers much more elastic than PAYE taxpayers, and high income taxpayers exceptionally responsive compared to low income taxpayers (Acheson et al; [The Elasticity of Taxable Income](#), 2018).

Table 3: Weekly jobseeker payment rates, single person, the 10th percentile of the earnings distribution and the year-on-year percentage change in the consumer price index, all nominal values, 2012-2018

Year	Weekly jobseeker payment rates, single person	Weekly earnings at 10 th percentile (€)	Annual percentage change in earnings at 10 th percentile	Annual change in the consumer price index
2012	188	179.9	-1.9	1.7
2013	188	180.8	0.5	0.5
2014	188	182.2	0.8	0.2
2015	188	183.9	0.9	-0.3
2016	188	191.9	4.4	0
2017	193	197.4	2.9	0.4
2018	198	202.9	2.8	0.5

Sources: CSO consumer price index, CSO earnings analysis, DSP annual statistical information report. Notes: jobseeker rates vary for those aged under 26, the maximum rate varies for jobseeker benefit depending on contributions; earnings data not yet available for 2019-2020.

4.1.1 Replacement rate calculations

The replacement rate is the proportion of earnings that the unemployment payment replaces. One component, the jobseeker rate, can be calculated on the basis of standard rates, according to a number of household types or on the basis of actual payment amounts received. However, selecting the appropriate level of earnings from employment is less straightforward. Earnings can be calculated over a recent period prior to unemployment or estimated based on labour market characteristics (age, sex, education level, occupation etc.). More typically, jobseeker rates are presented against average earnings or proportions thereof, as well as against the national minimum wage.

Often, replacement rate calculations cannot take account of secondary benefits, including services that are publically provided free to the end user once in receipt of a particular payment¹⁰. While replacement rates are typically compared internationally, with both numerator and denominator implicitly scaled by the cost of living in a given country, the variance in entitlement to secondary benefits is a major caveat to cross-country comparison.

¹⁰ For non-cash benefits, estimating the value based on cost per capita, risk-related, and market value approaches is discussed in Keane .C and Bercholz, M.; [Work incentives adjusting for childcare subsidies and healthcare benefits](#) (2019)

Finally, the interpretation of the replacement rate distribution is not always evident: with part of the distribution above 100% (meaning people in receipt of social welfare payments greater than what would be received in employment), employment decisions are evidently based on factors beyond the financial aspect.¹¹

In a comprehensive profile of financial incentives to work using microsimulation, Savage et al (2015) find strong disincentives to take up employment are infrequent and lone parents are the least likely to face very high replacement rates, meaning they will be financially better off by commencing work. The demographic profile of the unemployed (many of whom are young and do not have dependants) and the fact that the presence of child and adult dependents increases the rate of jobseeker payments is part of the reason for this. Those with a higher risk of high replacement rates include unemployed people with children, those with low potential wages, and unemployed persons in jobless households.¹²

Table 4 presents Eurostat calculations of the replacement rate based on a number of stylised households. The Irish and EU average rates are broadly similar, although their similarity is largely due to the inclusion of housing. If housing is excluded, for a single person without children in Ireland, 29% of average earnings are replaced by the maximum personal rate of the jobseeker payment, whereas 43% is the average value for the EU-27. The presence of children significantly increases the replacement rate in Ireland, to a much greater extent than in the EU-27.

¹¹ By estimating wages for unemployed people, research by the ESRI finds that nine out of ten of those in the labour market (either employed or unemployed) who face a replacement rate greater than 100% are in work, similar in proportion to the population facing lower replacement rates. See Savage (2015). 'A profile of financial incentives to work in Ireland'. - Dublin: Journal of the Statistical and Social Inquiry Statistical Society of Ireland, Vol.44.

¹² Jobless households are households where no member is in employment, i.e. all members are either unemployed or inactive. Over the past two years, the proportion of the working age population living in jobless households has been approximately 12.5%.

Table 4: Net Replacement rate (including UB, HB and SA) for Ireland and EU-27, based on seven months unemployment duration (2020)

% of average earnings	Geographic entity	Single person without children	Single person with two children	One earner couple, without children	One earner couple, with two children
100	Ireland	47.0	61.9	63.9	73.1
	EU-27	49.8	61.5	52.1	63.0
67	Ireland	55.2	64.1	73.5	78.5
	EU-27	57.0	68.8	61.2	72.6
50	Ireland	65.5	67.6	86.5	83.7
	EU-27	61.8	74.4	67.9	79.0

Source: [EU tax and benefits database](#)

For further consideration of this topic, it may be instructive to examine, in a future paper, not just the theoretical rate at various earnings points but the distribution of replacement rates based on earnings using administrative data. Although this will give a very precise measure of financial incentives, it will be specific to Ireland rather than forming part of a harmonised international comparison dataset.

4.2 Part-time to full-time

The second transition of interest is people moving from part-time to full-time work. While part-time work can be a choice that suits at certain stages, the long-term prospects of part-time workers suggest the taxation and welfare systems should smooth the path from part-time to full-time. On average, over the past five years, fewer than one in four part-time workers are underemployed – in other words, they describe themselves as not seeking full-time work.¹³ However, part-time work is

¹³ See [CSO](#), table QLF01. For an overview of part-time work, its importance in increasing the flexibility of labour markets since the 1990s, higher employment rates and work–life balance, as well as the associated wage penalty and lower career opportunities (partly self-selection and segregation into low-pay occupations), see [IZA](#).

associated with lower levels of training and low pay and the absence of the former makes it more difficult to progress to higher rates of pay.

Box 1: Marginal effective tax rate

- If gross earnings are €200 per week, subtracting tax of €30 and benefit withdrawal of €30 gives disposable income of €140. The marginal effective tax rate is then calculated as $1 - (140/200) = 30$ per cent.
- The higher the marginal effective tax rate, the bigger the difference between gross and net earnings and the lower the short-term financial incentive to increase earnings.

The marginal effective tax rate measures the fraction of additional earnings that is lost to benefit withdrawal or higher taxes on increasing hours of employment. In other words, in moving from part-time to full-time hours, it measures how much of the additional wages that would be paid are lost to withdrawal of some benefit and higher taxes through exhaustion of a tax credit or movement onto a higher rate of tax. The numerator in the marginal effective tax rate¹⁴ is the change in tax liabilities and benefit entitlements and the denominator is the associated increase in gross earnings.

Another measure is the participation tax rate, which can be interpreted as the impact of the tax and benefit system on the financial return to work. As with the replacement rate, the marginal effective tax rate and the participation tax rate measure the point-in-time incentive to increase hours and do not consider longer-term gains.

Savage et al (2015) find that one in ten partially unemployed people face a marginal effective tax rate of greater than 100% when moving from part-time to full-time employment, which suggests disposable income would be greater in part-time employment than full-time employment¹⁵. This increases to one in five for those with children. For recipients of One-parent Family Payment, an income support paid to lone parents, this is less common – only 6% faced the prospect of lower disposable income on foot of a move from part-time to full-time employment.

¹⁴ The marginal effective tax rate differs from the marginal tax rate discussed in section 7 - the rate of tax on an additional euro of earnings at a given point – which does not account for benefit withdrawal. The participation tax rate is calculated as one minus the financial gain to work as a proportion of gross earnings.

¹⁵ See later section on in-work supports for more on jobseekers eligibility to work part-time while in receipt of a jobseeker payment (up to three days in seven)

Table 5: Marginal effective tax rate on increasing working hours (including the impact of social assistance benefits and housing benefits) for Ireland and OECD (2019 – latest available data)

Family Type	Children	Wage Rate – 67% of the average wage (AW)		Wage Rate – average wage (AW)		Wage Rate – minimum wage (MW)	
		Increase in WH from 50% to 100% FTW	Increase in WH from 67 % to 100% FTW	Increase in WH from 50% to 100% FTW	Increase in WH from 67 % to 100% FTW	Increase in WH from 50% to 100% FTW	Increase in WH from 67 % to 100% FTW
Single Person	0	42 (Ireland) 44 (OECD)	39 (Ireland) 40 (OECD)	60 (Ireland) 39 (OECD)	71 (Ireland) 38 (OECD)	28 (Ireland) 45 (OECD)	33 (Ireland) 45 (OECD)
Single person	2	92 (Ireland) 55 (OECD)	93 (Ireland) 57 (OECD)	83 (Ireland) 54 (OECD)	87 (Ireland) 53 (OECD)	87 (Ireland) 48 (OECD)	88 (Ireland) 44 (OECD)
Couple – partner is out of work	0	37 (Ireland) 52 (OECD)	35 (Ireland) 49 (OECD)	60 (Ireland) 43 (OECD)	71 (Ireland) 41 (OECD)	78 (Ireland) 55 (OECD)	66 (Ireland) 50 (OECD)
Couple – partner is out of work	2	70 (Ireland) 59 (OECD)	69 (Ireland) 56 (OECD)	74 (Ireland) 53 (OECD)	76 (Ireland) 50 (OECD)	69 (Ireland) OECD (62)	69 (Ireland) 59 (OECD)
Couple – partner's earnings: AW	0	40 (Ireland) 34 (OECD)	41 (Ireland) 35 (OECD)	47 (Ireland) 37 (OECD)	49 (Ireland) 37 (OECD)	28 (Ireland) 25 (OECD)	30 (Ireland) 28 (OECD)
Couple – partner's earnings: 67% AW	0	32 (Ireland) 33 (OECD)	29 (Ireland) 35 (OECD)	37 (Ireland) 36 (OECD)	42 (Ireland) 37 (OECD)	28 (Ireland) 24 (OECD)	30 (Ireland) 27 (OECD)
Couple – partner's earnings: MW	0	70 (Ireland) 35 (OECD)	29 (Ireland) 34 (OECD)	32 (Ireland) 35 (OECD)	34 (Ireland) 35 (OECD)	82 (Ireland) 31 (OECD)	121 (Ireland) 34 (OECD)
Couple – partner's earnings: AW	2	40 (Ireland) 34 (OECD)	41 (Ireland) 36 (OECD)	47 (Ireland) 37 (OECD)	49 (Ireland) 37 (OECD)	28 (Ireland) 28 (OECD)	30 (Ireland) 30 (OECD)
Couple – partner's earnings: 67% AW	2	32 (Ireland) 38 (OECD)	29 (Ireland) 38 (OECD)	37 (Ireland) 28 (OECD)	42 (Ireland) 39 (OECD)	28 (Ireland) 36 (OECD)	30 (Ireland) 37 (OECD)
Couple – partner's earnings: MW	2	70 (Ireland) 46 (OECD)	87 (Ireland) 46 (OECD)	32 (Ireland) 41 (OECD)	34 (Ireland) 39 (OECD)	33 (Ireland) 43 (OECD)	27 (Ireland) 43 (OECD)

Source: [OECD Statistics on Benefits, Taxes and Wages](#)**MW** = National Minimum Wage; **AW** = Average Wage; **FTW** = Full Time Work; **WH** = Working Hours

4.3 People joining the labour force

The preceding discussion on encouraging employment makes clear the variance of labour supply decisions before and after the complexity added by the taxation and welfare systems. While the interaction of the taxation and welfare systems are neatly, if imperfectly, captured in measures like the marginal effective tax rates and replacement rates, the expansion of the labour force involves drawing in those categorised by the International Labour Organization (ILO) as economically inactive. The third transition of interest (people joining the labour force) refers to people who are neither employed nor unemployed according to the ILO definition.

Responses to financial incentives by those who join the labour force are difficult to generalise given the diversity of reasons for not being in the labour force (illness, disability, caring responsibilities, retirement etc.). People who are out of the labour force may be entitled to a range of other services and secondary benefits that make changes in labour market status more complex. Their interaction with the Public Employment Service is different from jobseekers in that there is no compulsory engagement and receipt of a payment, if any, is not conditional on job search.

The specific measures that apply to these cohorts are addressed in the section entitled 'Measures to address distance from the labour market'.

5. Secondary benefits

Secondary benefits are entitlements or services that are attached to a primary payment. The following allowances are secondary benefits that may, under certain circumstances, be paid to those of working age – most are secondary to illness and disability payments rather than jobseeker payments:

- Fuel Allowance,
- Free Travel,
- Living Alone Allowance,
- Island Allowance,
- Back to School Clothing and Footwear Allowance and
- the Household Benefits Package.

Secondary benefits are also a consideration when assessing how the taxation and welfare systems encourage employment. The immediate withdrawal of these benefits could represent a disincentive to take up work.

To counter this possibility, withdrawal of secondary benefits can be tapered – for example, the medical card is retained for up to three years by those who have been in receipt of a social welfare payment

for a year or more and who return to work. Dependent family members may qualify to keep their cards, even if they become employed during this three-year period. People on activation and training programmes (e.g. the Back to Education Allowance, Community Employment, and YESS) also retain medical cards. People who move from long-term illness or disability payments into employment can retain an entitlement to free travel for a period of five years.

While any withdrawal of secondary benefits is likely to inform decisions on taking up employment, they tend not to have an influence on the amount of net income received from employment. The exception is the medical card, possession of which attracts a reduced rate of USC (2%). Although not a secondary benefit, the development of the Housing Assistance Payment to replace Rent Supplement is an example of a move to an income-based support from one based on employment status or hours of work.

6. In-work supports

In-work supports are financial supports to people who are in employment but whose income falls below a certain threshold, and are usually calculated on the basis of family size. At the outset, it is worth noting the ‘at risk of poverty’ rate for those in employment in Ireland is among the lowest among EU member states.¹⁶ Although typically based on income and family size rather than labour market status, in-work supports may affect each of the three transitions of interest:

- unemployed people finding work
- people engaged in part-time work increasing their hours to full-time
- people joining the labour force

The design challenge of in-work support is to balance its dual objectives: to support low-income workers financially while encouraging greater work intensity and, ultimately, an end to receipt of income supports.

The main in-work support is the Working Family Payment (WFP), which is available to employees working a minimum of 38 hours per fortnight. There is no requirement to have been in receipt of a jobseeker payment. Approximately 50,000 families are in receipt of the payment, and while take-up has improved since the equivalent scheme in the 1990s, the number of current recipients may not represent the total number of families eligible for it.

¹⁶ The at risk of poverty rate for people aged 18-64 and in employment was 4.4% in 2019, see [Eurostat](#), table ilc_iw01.

For those who move into employment from a jobseeker payment or a One-parent Family Payment, an in-work support called the Back to Work Family Dividend (BTWFD) can be paid for up to two years, subject to remaining in employment. Receipt of either BTWFD or WFP is conditional on the presence of at least one child who normally lives with the claimant.

Jobseekers are eligible to work part-time while in receipt of a jobseeker payment (up to three days in seven) and to retain a payment in respect of the other days. Although identified as a jobseeker payment rather than an in-work support, this payment shares many of the characteristics of an in-work support. The fact that it is based on days rather than hours means there can be a fall in income where work in a given week exceeds three days and the jobseeker entitlement for that week is zero. Table 6 presents a stylised example where income decreases as the number of days worked increases. While having no dependants corresponds to a majority of people in receipt of jobseeker payments, the minimum wage applies to only one in 20 working age adults with no dependants, making it a less frequently occurring example.

Table 6: Withdrawal of benefit as days of employment increase – minimum wage worker with no dependants, eight-hour days.

Days of work	Hours worked, cumulative	Earnings disregard, €	Earnings, €	Jobseeker maximum personal rate, €	Jobseeker amount payable, €	Total income, €	Replacement rate %
0	0	N/A	0.0	203.0	203.0	203.0	N/A
1	8	20	80.8	203.0	166.5	247.3	82%
2	16	40	161.6	203.0	130.0	291.6	70%
3	24	60	242.4	203.0	93.6	336.0	60%
4	32	N/A	323.2	203.0	0.0	323.2	63%
5	40	N/A	368.7	203.0	0.0	368.7	55%

Source: [Benefit of work estimator](#) and secretariat calculations

While the days-based system mitigates the risk of a low number of hours spread across the maximum number of days (in a way that an hours-based system would not), eligibility based on days or hours may not be the optimal criterion by which income support is provided to those whose income is insufficient in light of their family circumstances. Furthermore, by taking family circumstances into account, and given that WFP is available only to people with children, in-work support creates different levels of payment and financial incentives for people who are otherwise in similar circumstances.

The ideal in-work support is designed to ensure that, while supporting low-income workers financially, there is an opportunity to progress to higher levels of productivity, higher pay and, ultimately, an end to receipt of income support.

7. Examples of the impact of taxation and welfare on earnings

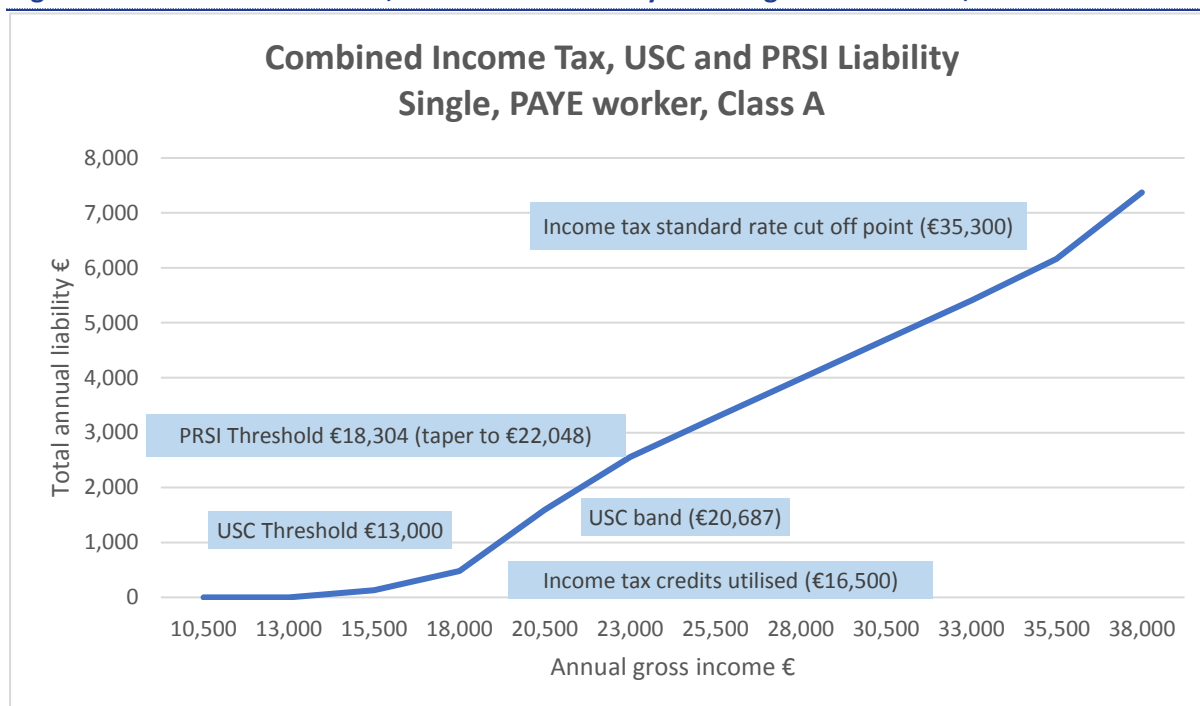
This section examines some of the factors affecting the transition from unemployment to employment to illustrate the complexity of taxation and welfare measures relevant to the discussion on encouraging employment. It outlines some of the thresholds at which higher marginal tax rates apply and some of the measures introduced to smooth step effects.

7.1.1 Overall progressivity of employment taxes and charges

Earnings are subject to income tax, USC and PRSI. The combined application of these charges means that various applicable rates are applied, depending on the levels of income earned. Ireland has one of the most progressive income tax systems in the developed world – the most progressive within the EU members of the OECD.

Figure 1 illustrates the progressive nature of how average earnings are treated in the case of a single PAYE worker who is liable to Class A PRSI.¹⁷ Over 70% of individuals earn less than €40,000 per annum, so it is appropriate to focus on the range in the below figure as it is representative of the substantial majority of workers in Ireland. Further analysis of the income distribution will be presented at future discussions, but it is worth noting that individuals with incomes of over €70,000 per annum are in the top 10% of income earners and those earning over €100,000 the top 3%.

¹⁷ Most employee's income is subject to Class A PRSI.

Figure 1: Combined income tax, USC and PRSI liability for a single PAYE worker, Class A PRSI

Source: Secretariat calculations

As the above shows, there is no charge until incomes reach €13,000 per annum in the case of a single PAYE worker, at which point USC becomes payable, and as annual gross income increases so too does the liability.

The effective rate of tax is the amount of tax paid as a percentage of overall income. The marginal tax rate is the rate of tax that is applied to additional income earned. In the above, the highest effective rate at income of €38,000 is 19.4%. The marginal rate at that point is 48.5% (comprising the 40% rate of income tax, 4.5% rate of USC and 4% rate of employees PRSI).

High marginal rates of taxation can have a negative impact on incentives to work for income earners, and lead to increased labour costs for employers who may have to offer a certain level of net income¹⁸ in order to attract employees in a competitive labour market.¹⁹

Marginal tax rates that are high by comparison to competitor jurisdictions can therefore have a negative impact on domestic businesses seeking to attract mobile highly-skilled workers. They can also be a negative factor in the location choices of foreign direct investment, a particularly important issue for the Irish economy.

¹⁸ Income after tax.

¹⁹ While employers may be able to mitigate some of these costs by offering payment in the form of other benefits instead of salary, the effect of high marginal rates remains.

The tax wedge is the difference between what an employer has to pay in gross wages plus taxes to hire an employee and the net income received by that employee after deduction of all taxes on wages. It is defined as the sum of personal income tax plus employee and employer social security contributions together with any payroll taxes less cash transfers²⁰, expressed as a percentage of labour costs²¹:

<p style="text-align: center;">TAX WEDGE ON LABOUR INCOME</p> $\frac{((\text{Personal income tax} + \text{employee and employer social security contributions (SSCs)}) - \text{Family Benefits})}{(\text{Total labour costs (gross wages} + \text{employer SSCs)})}$

High tax wedges particularly affect low-skilled workers, second earners and older cohorts, whose labour force participation is more sensitive to taxation. Reductions in the tax wedge on these groups can have significant impacts on participation rates, which can increase medium-term economic growth rates through the labour supply channel. Reductions in the tax wedge can also increase the demand for labour from employers. For these reasons, a competitive tax wedge is considered vital in encouraging employment growth across all income categories and to incentivise individuals to remain in or return to the labour market.

In international comparisons, according to the OECD Taxing Wages Report 2021 based on 2020 data:

- Ireland had the 13th lowest headline tax wedge (32.3%) of the 36 OECD members included for a single worker on average earnings, which sits below the average of 34.7%.
- In Ireland, income tax and employer social security contributions combine to account for 89% of the total tax wedge, compared with 76% of the total OECD average tax wedge.

7.1.2 Steps effects example: PRSI Credit

As set out in Figure 1 above, there are a number of points along the income range where the liability to tax increases, including €12,012 when the rate of USC goes from 0.5% to 2% or €16,500 when the income sheltered by the main personal income tax credits is fully utilised and the 20% rate of income tax applies to income above this amount.

Another point that is highlighted is the income range between €18,304 and €22,048. This is the annual equivalent of earning between €352 and €424 per week and is the range where the PRSI credit is applied to smooth out the significant step effect that would otherwise arise for Class A employees. The step effect arises because once the €352 weekly earnings threshold is exceeded the flat 4% rate of PRSI is applied to all the income. An increase in gross earnings beyond €352 therefore results in a

²⁰ This would include, for example, applicable payments from the State such as Working Family Payment

²¹ Gross wages plus employer social security costs.

number of anomalies, including a net income loss of €14.08 per week.²² The regressive nature of the step effect creates a disincentive to increased earnings for those at or around these income levels, which may include hourly paid minimum wage workers.

To address this, a PRSI credit was introduced in 2016 to reduce the amount of PRSI payable by people earning between €352.01 and €424 per week. The credit is tapered and the amount of the credit depends on the individual's weekly earnings. Upon earning €352.01 per week, the maximum PRSI credit of €12 applies, with the PRSI charge decreasing from €14.08 to €2.08. The net effect of the credit is to reduce or minimise the step effect of the increased weekly earnings, but comes with a trade-off of increased complexity.

8. The role of the Public Employment Service in encouraging employment

While the interaction of the taxation and welfare systems are often considered in terms of the financial consideration, engagement with the Public Employment Services, which is compulsory for those in receipt of jobseeker payments, is an important aspect of easing transitions from unemployment or inactivity to employment.

As well as receiving a payment that is calibrated to mitigate the risk of poverty at the household level while providing a financial incentive to move into employment, people in receipt of jobseeker payments have commitments to the Public Employment Service as part of an agreed set of mutual obligations.

Once registered with the Public Employment Service, jobseekers agree a personal progression plan and are required to meet case officers for job search advice and assistance at specified periods based on the risk of unemployment persistence. For jobseekers, engaging in this process is mandatory, with a reduction in the rate of payment applied as a penalty in the case of non-compliance.

The recent history of the Public Employment Services, particularly the changes over the past decade and the move from passive income support to active engagement with jobseekers, is outlined in the paper presented at the second meeting of the Commission, 'Social protection: main supports and programmes and key changes since 2009'.

The deployment of case officer resources within the Public Employment Service is targeted through an assessment of risk. By profiling jobseekers on the basis of the likelihood of becoming long-term

²² €352@ 4% rate applied

unemployed (durations greater than 12 months), the attention of case officers is focussed on those who need assistance. The volume of case officers in the medium term, and the number of engagements with jobseekers, will be outlined in the forthcoming Pathways to Work strategy.

Should jobseekers require additional training, they can be referred to the training courses provided under the national training authority, SOLAS. Eligible jobseekers may also participate in public employment programmes ([Community Employment](#), [TÚS](#)) and education programmes ([Back to Education Allowance](#)) and employers who hire long-term unemployed people may be entitled to subsidies ([JobsPlus](#)). Table 7 outlines the number of people participating in a selection of these programmes at points in 2019 and 2020.

Table 7: Number of people participating in various programmes, March 2019 and 2020

Programme name	March 2019	March 2020
Back to work enterprise allowance	5,764	3,786
Short-term enterprise allowance	310	276
Part-time job incentive	272	158
TÚS	6,303	5,339
Community employment	21,479	21,132
SOLAS full-time training	5,641	5,027
Vocational training opportunities scheme (VTOS)	2,947	2,704
Total	51,349	45,269

Source: CSO, LRM14.

The purpose of these programmes is to improve the employment prospects of people who are long-term unemployed (a majority of them are targeted at long-term unemployed people, although eligibility conditions vary). The extent to which they improve jobseekers prospects are estimated under the [DSP programme of counterfactual impact evaluations](#). These seek to identify the net effect of participation in these programmes, distinguishing those who would have found employment anyway from those whose prospects are improved by participation.

9. Measures to address distance from the labour market: benefits, exemptions and services

9.1 Identifying those distant from the labour market

Identifying cohorts who are further from the labour market is a considerable challenge if based on objective criteria. A starting point is those who are not in the labour force – that is, all those who are not in employment (regardless of whether they are seeking work)²³. This cohort encompasses students, retired people, those caring for children or elderly family members and people who are unable to work due to disability.

Typically, discussions about those facing some degree of labour market disadvantage extends beyond those outside the labour force to include lone parents, migrants, Travellers and Roma. However, a definitive list, or even a comprehensive data source from which to measure such disadvantage, is not a settled matter.

From administrative data and panel survey data such as the Labour Force Survey, we can identify some cohorts at some degree of labour market disadvantage. Lone parents, identifiable through household surveys and administrative data where they are in receipt of lone parent supports, have an employment rate and participation rate that is noticeably lower than for the working age population, or for couples with children (see Table 8).

Table 8: Employment, unemployment and participation rates of lone parents and all couples with children, 2020 (to Q3 2020)

Household type	Year	Employment rate	Unemployment rate	Participation rate
Lone parents	2020	56.4%	6.5%	60.3%
All couples with children	2020	75.5%	3.1%	77.9%

Source: CSO

Data on the labour market status of people with disabilities comes from either administrative data, household surveys or the Census. While the International Labour Organization (ILO) status derived from Labour Force Survey data is an objective and comparable measure that can be sorted into three categories, survey responses about disability and its life-limiting aspect are necessarily more subjective and cover a wider range of conditions.

Similarly, the identification of people as Travellers or Roma is based on subjective self-reporting and, even on that basis, is only occasionally captured in administrative data, all of which makes it difficult to measure progress over time. In general, any cohort that is small in number will be difficult to examine in detail in a dataset. Identifying a particular characteristic that is causally related to distance

²³ Although part of the labour force, the long-term unemployed, particularly those whose unemployment duration is substantially greater than one year could, arguably, also be included.

from the labour market is a further challenge, particularly where multiple barriers to employment co-exist.

9.2 Tax and welfare interactions for those distant from the labour market

A number of benefits and taxation measures have been designed with cohorts more distant from the labour market in mind. The objective is to provide a minimum level of income where people face particular barriers to the labour market. To facilitate an ongoing connection to work, income disregards typically apply for a portion of earnings. While an income disregard encourages employment up to a point, it may also make labour supply decisions more complex, particularly for employment that may be short-term or temporary.

The measures below are some of the features of the taxation and welfare systems that encourage employment for those who are distant from the labour market.

9.2.1 People with disabilities

A subset of people with disabilities are in receipt of Disability Allowance, a means-tested payment. Recipients can work and earn up to €120 per week (after the deduction of PRSI, pension contributions and union dues) without their payment being affected. Subsequently, 50% of earnings between €120 and €350 are disregarded in the Disability Allowance means test, with the balance fully assessed. The number of recipients of this payment has increased by 54% over the past decade, from 101,111 in 2010 to 155,601 in 2021.

People who have been in receipt of Invalidity Pension or Illness Benefit for at least six months and have a reduced capacity to work can apply for Partial Capacity Benefit. This allows them to engage in work while retaining a portion of Illness Benefit or Invalidity Pension, with the proportion based on a medical assessment of the severity of the restriction on work capacity.

9.2.2 Carers

Carer's Allowance has a weekly disregard of €332.50 (€665 for couples). The objective is to retain carers in the labour force, with a limit of 18.5 hours per week of work, given their primary status is as full-time carers.

Beyond the income support targeted at carers, the Home Carer Tax Credit is a tax credit for people who care for certain dependent persons and a credit is also available for persons who meet the everyday living costs of dependent relatives who cannot maintain themselves.

9.2.3 Lone parents

Those in receipt of the One-parent Family Payment or the Jobseeker Transitional Payment can earn up to €165 per week and receive the full adult rate of payment. Earnings from employment in excess of this amount are assessed at a rate of 50%.

Beyond the income support targeted at recipients of lone parent supports, the Single Person Child Carer Credit (€1,650 in 2021) is a tax credit for people who are caring for children on their own. A number of additional credits are also available for widowed persons or surviving civil partners with dependent children.

9.2.4 Secondary benefits

Secondary benefits, such as medical cards, are also a factor in labour supply decisions for those who are distant from the labour market. The medical card can be retained for up to three years by those who have been in receipt of a social welfare payment for a year or more and who return to work.

9.2.5 Services

The measures to encourage employment among Travellers and Roma are focussed on activation and training, specifically in the set number of places reserved on employment programmes. Such measures are expected to be outlined in greater detail in the forthcoming Pathways to Work 2021-2025.

The Public Employment Service (called Intreo) is available to all those considering joining the labour force, regardless of whether they receive a payment. Its services are also available to those who are in work, or who are returning to work after a period spent caring.

In summary, distance from the labour market is not a straightforward characteristic to identify. A starting point is people who are out of the labour force, but this is not a homogenous group. The measures to encourage employment among them will depend on their reasons for being out of the labour force. Of the payments outlined above, despite the different contingencies these payments provide for, their overarching objective is the provision of income support while setting the right incentives for some degree of employment.

The last strategy with a focus on increasing employment by attracting people to join the labour force was in 2019 (see Future Jobs strategy) and the topic is likely to re-emerge as a priority as volumes in employment return to pre-pandemic values. In tandem, the forthcoming Pathways to Work strategy will outline the ambition of providing employment services and opportunities to all those who have a capacity to contribute.

9.3 The household dimension

The jobless household rate for the working age population had been decreasing steadily until 2020 (9.6%). Its highest level in the past decade was 15.8% in Q4 2012, the same quarter in which unemployment peaked. However, the jobless household rate decreased more slowly than the rapid decrease in the unemployment rate and, in contrast to the unemployment rate, Ireland's jobless household rate remained above the EU average until 2019.

The jobless household rate is driven largely by inactivity rather than unemployment, with the person's illness or disability the most frequent reason for being out of the labour force. Other factors for being out of the labour force include responsibilities for care of children or incapacitated adults, other family responsibilities or participation in education or training. It is most frequent in the 35-44 and 45-54 year age groups.

The relevance of the jobless household measure depends on the extent to which aspects of household joblessness present a policy challenge that exists beyond the standard measures of unemployment and inactivity. In other words, the question is whether there is something significant about the household rather than the individual that means a jobless household requires greater policy attention than an individual who is unemployed or inactive.

One scenario where measurement and analysis at the household level is more relevant is where differences in labour market prospects are exacerbated by changes in the household formation process. This trend is evident in a number of countries over recent decades. Although not particularly recent, an analysis of Census 2006 results published in 2011 looks at the long-term trend and concludes that, unlike many advanced economies, there is no evidence in Ireland of a greater prevalence of those with higher levels of education forming households together.

The matter is perhaps of greater concern in respect of children than working age adults. Table 10 shows the share of children living in jobless households – it was close to double the EU average in 2011 and, despite consistent decreases, remained above the EU average every year since.

Table 9: Working age people living in jobless households: share of persons aged 18-59 who are living in households where no-one works as a proportion of all in that age cohort, 2009-2020

Year	European Union - 27 countries (from 2020)	European Union - 28 countries (2013-2020)	Ireland
2009	10.0	10.2	12.4
2010	10.3	10.5	14.4
2011	10.4	10.6	15.4
2012	10.8	10.9	15.7
2013	11.3	11.2	14.4
2014	11.1	11.0	12.9
2015	10.8	10.6	11.7
2016	10.3	10.2	10.9
2017	9.7	9.6	9.8
2018	9.1	9.0	9.4
2019	8.8	8.7	8.6
2020	9.2	:	9.6

Sources: Eurostat, lfsi_jhh_a

Table 10: Children living in jobless households: share of persons aged 0-17 who are living in households where no-one works as a proportion of all in that age cohort, 2009-2020

Year	European Union - 27 countries (from 2020)	European Union - 28 countries (2013-2020)	Ireland
2009	9.0	10.2	16.9
2010	9.5	10.7	19.7
2011	9.8	10.9	20.3
2012	10.2	11.2	20.2
2013	10.6	11.3	17.7
2014	10.5	11.1	15.9
2015	10.3	10.7	14.3
2016	10.2	10.5	13.2
2017	9.5	9.8	11.8
2018	9.1	9.4	11.4
2019	8.7	9.0	10.9
2020	9.0	:	11.1

Sources: Eurostat, lfsi_jhh_a

There are a number of factors that explain at least some of the difference in the proportion of people living in jobless households in Ireland and the EU, particularly with regard to children.

- The average number of children per household, across all households, is higher in Ireland compared to the EU average (0.8 compared to 0.5)
- The average number of children per household, for single adults with children, regardless of employment status, is higher, at 1.8 in Ireland compared to 1.5 in the EU average
- The average number of children living in jobless households is higher in Ireland, at 0.3, than the EU average, 0.1
- For lone parents in jobless households, the average number of children per household is higher in Ireland (an average of two) compared to the EU (where the average is 1.7).

Of the lone parents in employment, a greater share are employed part-time in Ireland (over one third compared to approximately one quarter across the EU). This does not, of itself, increase the number of people living in jobless households but given that lone parent households have a greater probability of becoming jobless households (by virtue of nothing more than the number of adults who can potentially be at work in the household) and the fact that part-time work is associated with lower accumulation of firm-specific human capital, the risk of part-time employment leading to a jobless household is greater in this case.

The jobless households indicator highlights the role of child and family income supports to alleviate the risk of poverty among children living in households where no one works.

Finally, although outside the scope of this paper, the ambition of a taxation and welfare system that facilitates employment coexists with the requirement to provide the safety net of income support and to redistribute income to some desired extent.

10. Proposals for the Commission – forward looking

As part of the next phase of work, the following topics are areas the Commission may wish to focus on:

- Matters relevant to the redistributive elements of Ireland's taxation and welfare systems including:

- Average wages and incomes (including sectoral elements), household expenses, wealth levels and sources of income, types of households (individual, household, children)
 - The main drivers of poverty and market income inequality in Ireland
 - How effective the tax and welfare system is in achieving its objectives (poverty alleviation, inequality reduction) using a variety of measures.
 - The overall balance between personal, consumption and capital taxes in Ireland.
- Matters relevant to labour market participation and work incentives including:
 - Replacement rates, participation rates, trends in age-specific participation rates and the likely response to policy change.
 - The impact of the income tax system, including ETR and MTR, targeted measures like the home carer credit and structural elements including the joint assessment.
 - The impact of the welfare system, including measures such as the Working Family Payment, short-time work schemes, the impact of the withdrawal of benefits and choices around thresholds for income disregards.
 - The impact of other factors including the quality of jobs (legal forms, other benefits such as pension contributions, sick pay etc).
 - Incentives for vulnerable groups, trends in illness and disability prevalence and number of recipients
 - The scope and scale of the Covid-related policy response - subsidies, income support, delivery mechanisms (especially digital platforms)
- Other matters relevant to incomes from work in Ireland including:
 - The cost of employment including the impact of employer PRSI and other related matters such as pension auto-enrolment and sick pay
 - Factors impacting on Ireland's international competitiveness including the tax wedge, international mobility elements (and the relationship to encouraging economic activity and international tax).
- Tax and welfare interactions, including the transitions between unemployment and employment:
 - Developing further the analysis of relevant income traps and step effects.
 - Differences in the tax treatment of income and differences in the basis of assessment.
 - Lessons learned and takeaways from the Covid-19 pandemic response.

Appendix 1: Recommended reading

Two Government strategies, the National Economic Recovery Plan (NERP), which was published in June, and the Pathways to Work 2021-2025 strategy, which will be published shortly, provide an indication of future developments relating to employment.

The report by the National Economic and Social Council published in November 2020, '[The Future of the Irish Social Welfare System: Participation and Protection](#)', outlines the following areas of change:

- ensuring income adequacy and alleviating poverty, with the introduction of a two-tier child income support (rather than the current three-tier structure), that would comprise a universal child benefit paid in respect of all children, with an automatic supplement payable in respect of children in low-income families;
- supporting high participation through a participation income pilot and the extension of the Working Family Payment to low-paid workers without children who are at risk of poverty; and
- enhancing financial sustainability, by increasing PRSI contribution rates, especially for the self-employed, assessing tax on all forms of income, expanding capital and property taxes, with fewer exemptions, capping tax expenditures; and applying multiple rates of income tax.

The report will be summarised in a memorandum to be presented to the Commission.

Additional reading

Labour supply, taxation and welfare

- Chapter 2, Means testing and tax rates on earnings, from the [Mirrlees Review](#)
- Chapter 3, Labour supply and taxes from the [Mirrlees Review](#)
- Tax Strategy Group papers on [social protection](#), [PRSI for self-employed workers](#) and [income tax](#)
- ESRI Paper: [COVID-19 and the welfare system](#)
- Richard Blundell, [How responsive is the labor market to tax policy?](#)