Research Briefing

Social impact assessment of the welfare and income tax measures in Budget 2017

November 2016

This briefing presents a social impact assessment of the main welfare and tax measures in Budget 2017. It includes the increase in the national minimum wage and revised rent limits for housing support payments. It also includes the Christmas Bonus payable in December 2016.

Social impact assessment is an evidence-based methodology which estimates the likely effects of policies on household incomes, families, poverty and access to employment.

The assessment was prepared by the Department of Social Protection. It is based on the tax/welfare microsimulation model SWITCH developed by the Economic and Social Research Institute.

Responsibility for the analysis rests solely with the Department of Social Protection.

An Roinn Coimirce Sóisialaí
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Main findings

- Average household incomes increase by 1 per cent (€9.20 per week) as a result of Budget 2017.
- The bottom two income quintiles gain most, with smaller gains among the middle and top quintiles. The bottom quintile gains over three times that of the top quintile.
- Social welfare measures primarily benefit the bottom two quintiles. The weekly payment increase for pensioners results in the bottom quintile gaining 0.3 per cent. The other welfare measures, including the rate increase for working-age adults, benefit those in this quintile by 0.9 per cent.
- Income tax measures, though spread across all quintiles, are most beneficial to middle and higher income groups (0.6 per cent).
- Non-earning households gain most from Budget 2017. Non-earning lone parents and couples with children gain the most at 4.5 and 4.2 per cent respectively.
- Other family types that experience above average gains include non-earning couples and singles with no children, retired couples and singles, and earning lone parents.
- The population at-risk-of-poverty rate falls by 0.8 percentage points so social transfers continue to perform strongly in reducing poverty.
- The bottom quintile benefits most from the increase to rent limits for housing support payments. There is a negligible impact (c. 0.01 per cent) from the increase to the minimum wage.
- Compared to the previous year, Budget 2017 has a stronger progressive pattern with bigger gains for the bottom quintile and smaller gains in the remainder.

Introduction

The Programme for Partnership Government provides a commitment to developing a process of budget and policy proofing as a means of advancing equality, reducing poverty and strengthening economic and social rights. This builds on existing practices for ex-ante consideration of budget proposals including pre-budget forums, submissions and now the advance publication of Tax Strategy Group papers, which include analysis of illustrative budgetary measures[i].

This briefing presents the social impact assessment of the welfare and income tax measures in Budget 2017, including the Christmas Bonus payable in December 2016 and increases in the national minimum wage and rent limits[ii] for housing support payments.

Social impact assessment is an evidence-based methodology to estimate the likely distributive effects of policy proposals on income and social inequality. It is a widely used tool at the European level.[iii] Though relatively new in the Irish context, it builds on poverty impact assessment and is similar in concept to 'equality budgeting'.[iv]

The assessment supports the implementation of the national social target for poverty reduction, which is to reduce consistent poverty to 4 per cent by 2016 and to 2 per cent or less by 2020. It also informs Government policy on improving living standards among low and middle income families, reducing inequality and improving poverty outcomes.[v]

Social transfers and taxes have a key role in reducing income inequality and preventing poverty. CSO data show that social transfers (excluding pensions) reduced the at-risk-of-poverty rate from 37.4 per cent to 16.3 per cent in 2014, thereby lifting over a fifth of the population out of income poverty.

This briefing was prepared by the Department of Social Protection, after consultation with the Department of Finance on the income tax elements of Budget 2017. It builds on ex-ante analyses to inform ministerial deliberations on the tax and welfare elements of the Budget. It is intended to inform public understanding of the distributive impact of budgetary policy.[vi]

Methodology

The assessment uses a tax-welfare simulation model developed by the Economic and Social Research Institute (ESRI) known as SWITCH.[1] The model simulates the impact of changes in welfare and income tax for a representative sample of 8,000 households, drawn from the 2013/2014 *CSO Survey on Income and Living Conditions*, with the data updated to reflect trends in population, employment and incomes.[vii] Responsibility for the analysis rests with the Department of Social Protection.

The assessment covers the welfare and income tax measures announced in Budget 2017. The assessment also includes the impact of increased rent limits introduced to provide increased stability to tenants. Other social expenditure measures in relation to healthcare, affordable childcare, education and social housing are, however, not included. Government departments are working with the ESRI to improve the capacity of the SWITCH model to support such analyses.

The assessment includes the impact of budgetary measures on financial incentives to work, which is directly relevant to policy on unemployment and poverty.[viii] The Budget 2017 assessment includes the impact of the increase in the national minimum wage. While paid for by employers, this is a Government-sanctioned initiative designed to boost the incomes of workers on low earnings.

The comparator policy in the analysis is the 2016 policy which freezes taxes and welfare payments in nominal terms. The analysis of the individual measures and the costings are similar to those in the ESRI analysis, though it uses a different comparator policy.[2]

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[1] Simulating Welfare and Income Tax Changes

[2] The ESRI use a wage-indexed policy; see: www.esri.ie/news/budget-2017-distributive-impact/.

The welfare and income tax measures

The measures included in the assessment are presented in **Table 1** together with official costings. There are five social welfare measures included in the analysis, with full-year expenditure of €643.5 million. The cost for the increase in Guardian's payments is included with the costs for the increases in the weekly rates.

For the first time since 2009, the Budget has increased weekly welfare rates for working-age adults. These increases will be introduced from March 2017. The assessment is based on the increased rates applying for the full year.

The income tax items include a reduction to the three lowest USC rates of 0.5 per cent, and improvements in the Home Carer Tax Credit and the Earned Income Credit. These have a total annual expenditure of €375 million. Details of the budgetary measures are in the Budget 2017 documentation.[ix]

The final component relates to increasing the national minimum wage for adults from €9.15 to €9.25 per hour (1.1 per cent increase).

Other social expenditure measures in relation to healthcare, affordable childcare, education and social housing are not included in the analysis. However, work is underway to model the Housing Assistance Payment and Affordable Childcare Scheme. The working assumption in the analysis is that water charges are retained at last year's levels.

The impact modelled is on the level and distribution of 2017 incomes, with an allowance made for increased earnings in the economy over the data base year (2014). The distributive impact on household income is measured by income quintile (five equally sized groups ranked by equivalised income)[3] and by family types (14 categories differentiated by composition and employment status). The impact on at-risk-of-poverty is based on the 60% median income threshold, disaggregated by social group.[4]

Table 1: Summary of welfare & income tax measures for 2017 & official costs (full year)

Measures	Official cost €m
Social welfare	**643.5**
• €5 weekly rate increase for pensioners with proportionate increases for qualified adult dependants	148
• €5 weekly rate increase for working-age adults with proportionate increases for qualified adult dependants and other recipients on reduced rates	200
• Additional €10 increase in Guardian's Contributory and Non-Contributory payments	-
• €20 increase in the weekly income disregard for parents getting the One Parent Family Payment and Jobseeker's Transition	9
• An 85% Christmas Bonus paid in December 2016 to recipients of long-term social welfare payments	221
• Increase in the rent limits for housing support payments[5]	65.5
Income tax	**375**
• €100 increase in the Home Carer Tax Credit to €1,100	7
• €400 increase in the Earned Income Credit to €950	33
• Reduce the USC rates from 1% to 0.5%, from 3% to 2.5% and from 5.5% to 5%. Also, increase in the ceiling band for the 2.5% USC rate to €18,772.[6]	335

[3] The weekly value of each quintile is: 1: <€285; 2: <€404; 3: <€522; 4: <€672; and 5: >€672.

[4] This includes the impact by life-cycle and gender. Consideration of the impact on people with disabilities or ethnic minorities is not technically possible at present. Future developments may rectify this.

[5] €55m for rent supplement and €10.5m for the HAP customer base

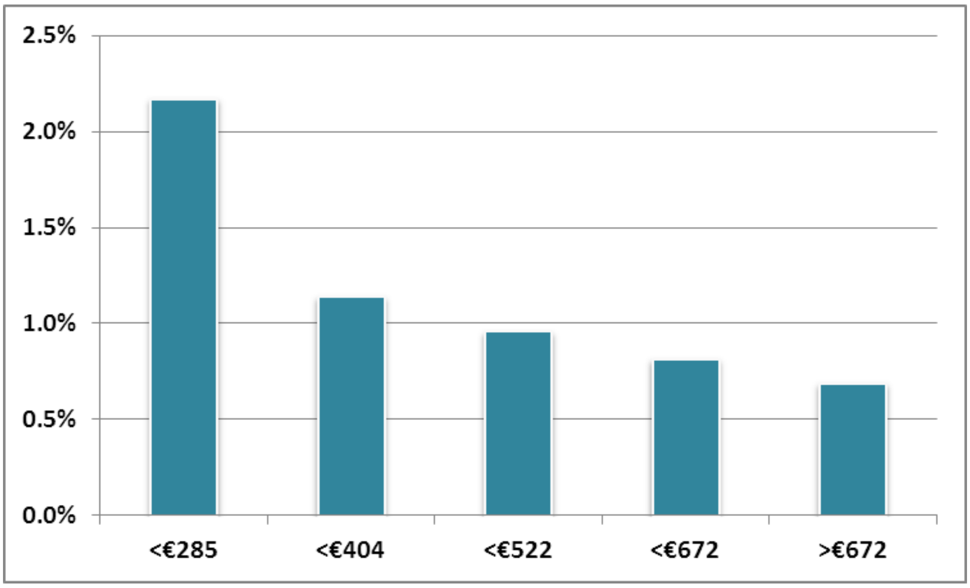
[6] This increase ensures the salary of a full-time worker on the minimum wage remains outside the top rates of USC.

Distributive impact of the Budget 2017 measures

Based on the SWITCH model, the gain in average household income as a result of the budgetary measures is 1 per cent, the equivalent of €9.20 per week. In all, 98.8 per cent of households benefit from the Budget, though the percentage is slightly lower in the bottom quintile (96.5 per cent).

Diagram 1 shows the distributive impact as measured by percentage change by income quintile. The greatest gains are for the lowest income quintile at 2.2 per cent, followed by the second lowest quintile at 1.1 per cent. The third quintile gains the average, while the fourth and fifth quintiles gain just below that, at around 0.8 per cent.

Diagram 1: Distributive impact of the composite 2017 measures
(Percentage gain in household income by equivalised income quintile)

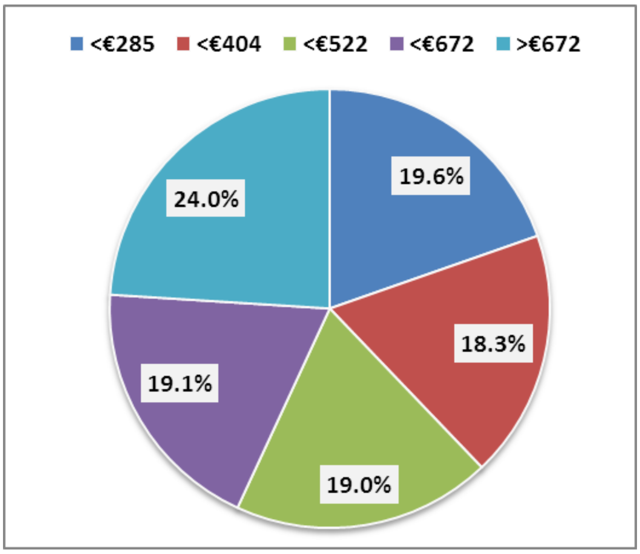


Source: SWITCH, the ESRI tax-benefit model

Diagram 2 presents the distribution of SWITCH estimated net costs of the measures.

- The largest contribution goes to the top quintile at 24 per cent.
- The second quintile receives 18.3 per cent of the expenditure.
- The bottom, third and fourth quintiles get around 19 per cent of the estimated expenditure.

Diagram 2: Distribution of aggregate expenditure
(Percentage contribution by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

Distributive impact of the component measures

Table 2 summarises the net cost and impact of the two main budgetary components using SWITCH. The welfare measures amount to €357.2 million (net), resulting in an average gain of 0.4 per cent in household income. The baseline policy for the SWITCH comparison includes the Christmas Bonus of 75 per cent paid in 2015.

The income tax measures have the largest net cost at €465.6 million. In turn, these have the greatest impact, with an average household gain of 0.5 per cent.

Table 2: SWITCH estimate of net cost and impact of the tax and welfare component measures in Budget 2017[7]

Measure	Net cost	Impact
Social welfare	€357.2m	0.4%
Income tax	€465.6m	0.5%

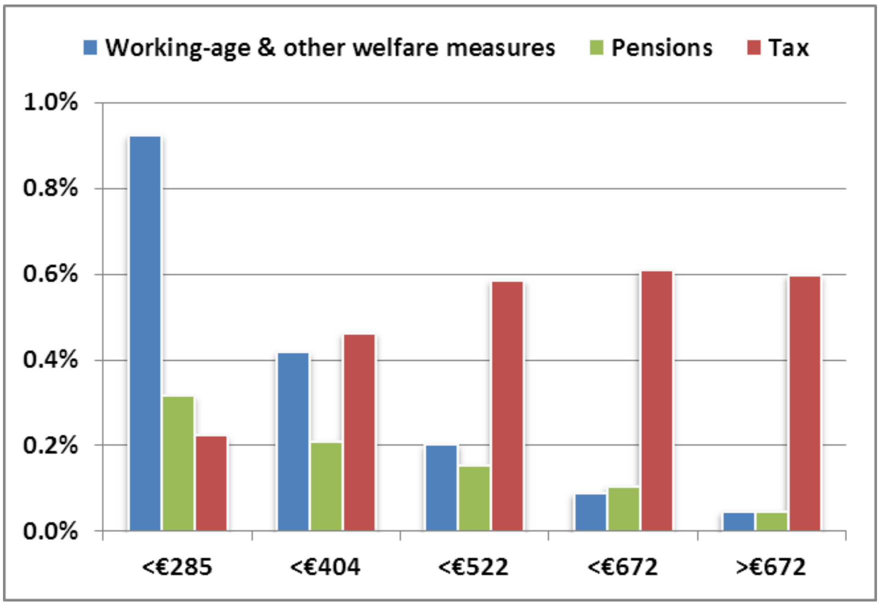
Source: SWITCH, the ESRI tax-benefit model

Diagram 3 shows the distributive impact of the component measures by income quintile. The distributive impact varies considerably by measure. Focusing on the working-age weekly increase and other welfare measures (i.e. guardian's payment, lone parent disregard and Christmas Bonus), the gains are concentrated in the bottom two income quintiles (0.9 and 0.4 per cent respectively).

The weekly rate increase for pensioners resulted in above average gains in the bottom three quintiles. The bottom quintile gains 0.3 per cent, while the other two gain 0.2 per cent.

The income tax measures are most beneficial to middle and higher income groups (0.6 per cent), though with average gains also for the second quintile.

Diagram 3: Distributive impact of the main Budget 2017 components
(Percentage gain in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

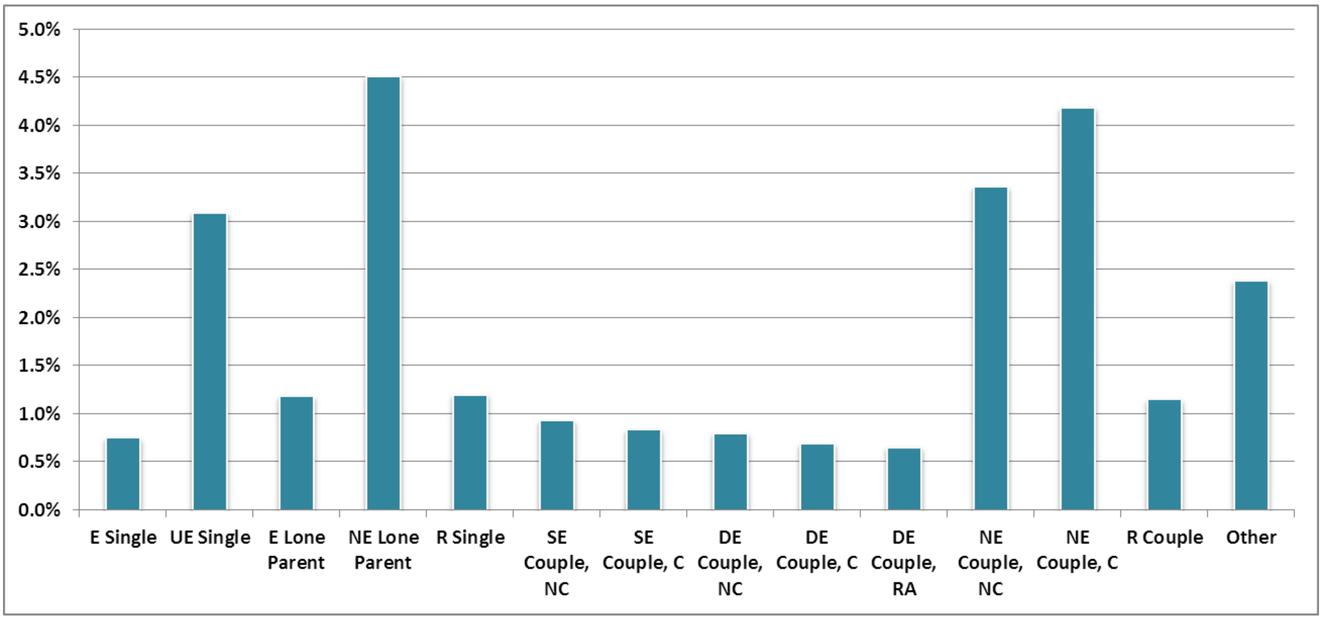
[7] The SWITCH costings differ from the official figures due to the Christmas Bonus, the impact of any tax or welfare offsets (e.g. any tax paid on increased welfare rates) and as not all beneficiaries of the rate increases are captured in the model.

Impact on family types

Diagram 4 presents the distributive impact of the composite 2017 measures on family types.[8] The main findings are:

- Generally, non-earning households gain more than other household types from the budget measures.
- The biggest beneficiaries are non-earning lone parents and couples with children, gaining 4.5 per cent and 4.2 per cent respectively.
- Non-earning couples and singles with no children also gain above average (around 3.3 per cent).
- Other family types[9] gain 2.4 per cent, again above the average of 1 per cent.
- Retired households (couples and singles) and earning lone parents experience gains slightly above average at almost 1.2 per cent.
- The remaining households also see income gains as a result of Budget 2017, but at lower than average rates.

Diagram 4: Distributive impact on families of the composite 2017 measures
(Percentage change in income by family type)*



Source: SWITCH, the ESRI tax-benefit model
* E=employed; UE=unemployed; NE=non-earning; R=retired; SE=single earner; DE=dual earner; RA=relative assisting; C=children; NC=no children

Impact on at-risk-of-poverty

The poverty threshold of 60% median income increases by 0.8 per cent as a result of the Budget measures. Despite this, the population at-risk-of-poverty falls by 0.8 percentage points.

This suggests the strong performance of social transfers to date in alleviating income poverty is likely to continue.

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[8] In some cases, a number of family types may live in the same household.

[9] The other family type includes a mix of people in education, who are ill/disabled (single, and in couples if male is disabled), and single people in home duties.

Impact on work incentives

This section analyses the impact of the 2017 budgetary measures on work incentives for those who are unemployed and in receipt of jobseeker's payment. It uses replacement rates to measure the proportion of in-work income that would be kept or replaced when out of work.[x]

Looking at the overall distribution of replacement rates, the model shows that the majority of people at work (85 per cent) or unemployed and receiving a jobseeker payment (82 per cent) have strong financial incentives to work (i.e. replacement rates ≤ 70 per cent).

Marginal Effective Tax Rates (METR) measure what part of any additional earnings are "taxed away" through the combined effect of increasing tax and decreasing benefit. METRs can be used to evaluate the extent of changes in tax and benefit policies in the Budget on work incentives.

As a result of Budget 2017, almost 70% of the working population experience a reduction in their Marginal Effective Tax rate (METR).

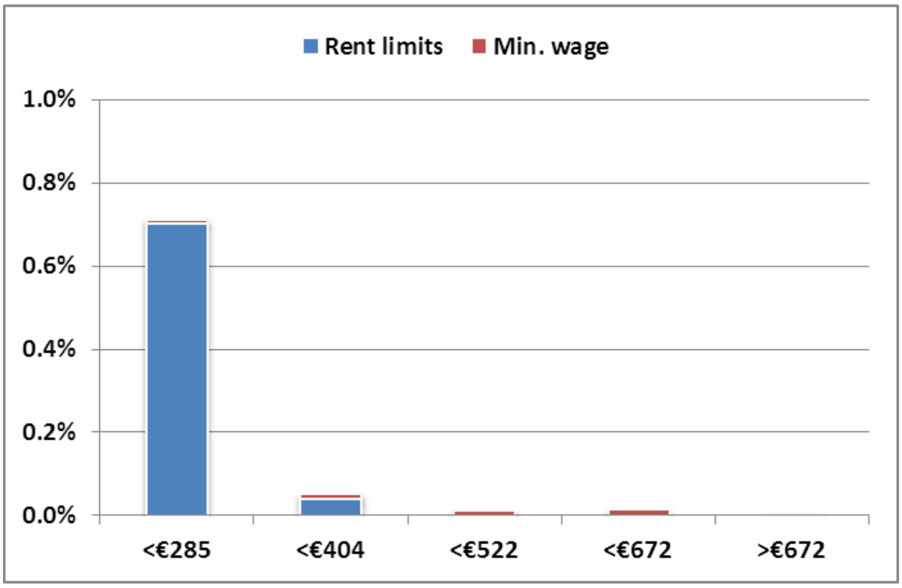
Distributive impact of increases in the national minimum wage and the rent limits for housing support payments[10]

Diagram 5 shows the distributive impact of the increases to rent limits for housing support payments and the national minimum wage by income quintile.

The increase to the rent limits for housing support payments is of greatest benefit to the lowest income quintiles. The bottom quintile is the main beneficiary, gaining a 0.7 per cent increase in household income.

The average gain from the increase to the national minimum wage is negligible at 0.01 per cent.[xi]

Diagram 5: Distributive impact of the composite 2017 measures
(Percentage gain in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

[10] To analyse the potential impact of a change in the national minimum wage, SWITCH simulates it for the 2016 baseline, over-riding the actual wages of those below the national minimum wage level. The model does not take into account the increased payments by employers, or the downstream impact of increased employer costs on other incomes in the economy (e.g., profits, dividends).

Distributive impact of Budget 2017 compared with Budget 2016

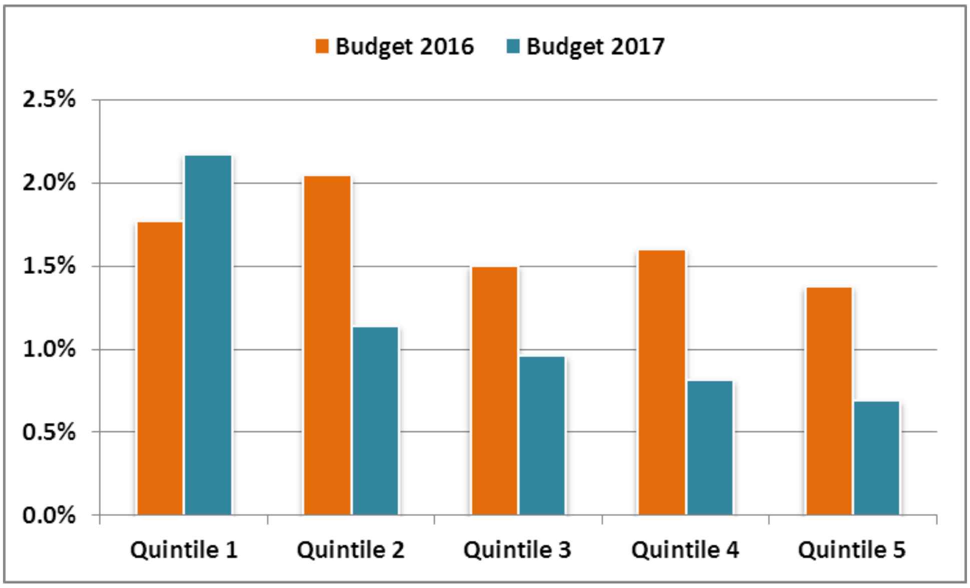
Finally, the distributive impact of the budgetary package for 2017 is compared with the 2016 policy – see **Diagram 6**. The average gain in 2017 is 1 per cent. This compares to 1.6 per cent in 2016.

Budgets 2016 and 2017 benefit all income quintiles but in different proportions. This reflects the fact that Budget 2017 combines modest increases across the board with some more targeted measures.

The bottom quintile gains more in Budget 2017, compared to Budget 2016. However, the remaining quintiles gain less.

Budget 2017 has a stronger progressive pattern with the bottom quintile gaining 2.2 per cent, over three times the gain of the top quintile (i.e. 0.7 per cent). This compares to a ratio of 1.3 between the gains in the lowest and highest quintiles in Budget 2016.

Diagram 6: Distributive impact of Budget 2016 and Budget 2017
(Percentage gain in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

References

[i] Published budget documentation includes preliminary information on the distributional effects of the Budget 2017. The Department of Public Expenditure and Reform developed a new SIA framework, which aims to broaden the scope of the current SIA practice to take account of not only tax and social welfare measures, but also assess how changes in public expenditure policy can impact on household outcomes and living standards. See: www.finance.gov.ie/what-we-do/tax-policy/publications/pre-budget-submissions/pre-budget-submissions; www.finance.gov.ie/what-we-do/tax-policy/tax-strategy-group/tsg-2016/publication-tax-strategy-group-papers-and-income; and http://budget.gov.ie/Budgets/2017/2017.aspx.

[ii] See: www.welfare.ie/en/pressoffice/Pages/pr280616.aspx

[iii] See: http://ec.europa.eu/social/main.jsp?catId=89&langId=en&newsId=935&furtherNews=yes

[iv] See: www.equalitybudgeting.ie

[v] See: A Programme for a Partnership Government at: www.taoiseach.gov.ie/eng/Work_Of_The_Department/Programme_for_Government/A_Programme_for_a_Partnership_Government.pdf

[vi] See: www.socialinclusion.ie/NPT.html

[vii] Information on the design, underlying data and model construction can be found at: www.esri.ie/research/taxation-welfare-and-pensions/.

[viii] Callan, T., O'Dea, C., Roantree, B. and Savage, M. (2016), *Financial Incentives to Work: Comparing Ireland and the UK,* Budget Perspectives 2017 Paper 2, Dublin: ESRI. See: www.esri.ie/publications/financial-incentives-to-work-comparing-ireland-and-the-uk/

[ix] See: www.welfare.ie/en/Pages/Budget-2017.aspx and www.budget.gov.ie/Budgets/2016/2016.aspx

[x] Savage, M., Colgan, B., Callan, T., and Walsh, J.R. (2015), *Making Work Pay More: Recent Initiatives*, Budget Perspectives 2016 Paper 2, Dublin: ESRI. See: www.esri.ie/publications/making-work-pay-more-recent-initiatives/

[xi] See ESRI study on *Low Pay, Minimum Wages and Household Incomes: Evidence for Ireland* for more analysis on this topic at: www.esri.ie/pubs/BP201703.pdf