Research Briefing

Social impact assessment of the welfare and income tax measures in Budget 2018

December 2017

This briefing presents a social impact assessment of the main welfare and tax measures in Budget 2018. It includes the increase in the national minimum wage and the Christmas Bonus payable in December 2017.

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 Employment Affairs and 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 Employment Affairs and Social Protection.

Main findings

- Average household incomes increase by 1.1 per cent (€11.40 per week) as a result of Budget 2018.
- The bottom two income quintiles gain most, with smaller gains among the middle and top quintiles. The bottom quintile gains over twice 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 0.4 per cent. The other welfare measures, including the rate increase for working-age adults, benefit those in this quintile by 1.1 per cent.
- Income tax measures are spread relatively evenly across the second, third, fourth and fifth quintiles, with average gains of 0.75 per cent.
- Non-earning households gain most from Budget 2018. Non-earning lone parents, non-earning couples (with and without children) and non-earning singles gain the most at 2.5, 2.8 and 3 per cent respectively.
- Other family types that experience above average gains include employed lone-parents, single-earner couples with children and retired singles.
- The population at-risk-of-poverty rate falls by 0.6 percentage points so social transfers continue to perform strongly in reducing poverty.
- There is a negligible impact of less than 0.1% from the increase to the minimum wage.
- Compared to the previous year, Budget 2018 has a similar progressive pattern with bigger gains for the bottom quintile and smaller gains in the remainder.

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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 direct tax measures in Budget 2018, including the Christmas Bonus payable in December 2017. The assessment also includes the effects of the increase in the national minimum wage.

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.[ii] It builds on poverty impact assessment and is similar in concept to 'equality budgeting'.[iii]

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.[iv]

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 34.9 per cent to 16.9 per cent in 2015, thereby lifting almost a fifth of the population out of income poverty.

This briefing was prepared by the Department of Employment Affairs and Social Protection, after consultation with the Department of Finance on the direct tax elements. 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.[v]

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.[vi] Responsibility for the analysis rests with the Department of Employment Affairs and Social Protection.

The assessment covers the welfare and direct tax measures announced in Budget 2018. Social expenditure measures in relation to healthcare, affordable childcare, education and social housing are not included.

The assessment includes the impact of budgetary measures on financial incentives to work, which is directly relevant to policy on unemployment and poverty.[vii] The Budget 2018 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 Budget 2017 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]

[1] Simulating Welfare and Income Tax Changes

[2] The ESRI use a wage-indexed comparator 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 seven social welfare measures included in the analysis, with full-year expenditure of €648 million.

For the second year in a row, the Budget has increased weekly welfare rates for adults. These increases will be introduced from March 2018. The assessment is on the basis of the increased rates applying for the full year.

The direct tax items include a reduction in two of the USC rates by 0.5 percentage points, increases in the standard rate cut-offs for income tax and increases in the Home Carer Tax Credit and the Earned Income Credit. These have a total annual expenditure of €397 million. Details of the budgetary measures are in the Budget 2018 documentation.[viii]

The final component relates to increasing the national minimum wage for adults from €9.25 to €9.55 per hour (3.2 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 impact modelled is on the level and distribution of 2018 incomes, with an allowance made for increased earnings in the economy over the survey 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 2018 & official costs (full year)

Measures	Official cost €m
Welfare	**648**
• €5 increase in the maximum weekly rate for working-age people and young jobseekers with proportionate increases for adult dependents	191.8
• €5 increase in the maximum weekly rate for pensioners with proportionate increases for adult dependents and those on reduced rates of payment	151.4
• An increase of €2 per week for qualified child dependents	37
• An increase of €10 per week in the income thresholds of the Family Income Supplement for families with up to three children	16
• €20 increase in the weekly income disregard (up to €130) for parents getting the One Parent Family Payment or Jobseeker's Transition	8.4
• Increase in supplementary payments (telephone support allowance and the extension of fuel season by one week)	24.8
• An 85% Christmas Bonus paid in December 2017 to recipients of long-term social welfare payments	218.6
Income tax	**397**
• An increase of €750 in the income tax standard rate band for all earners	152
• €200 increase in the Earned Income Credit to €1,150	31
• €100 increase in the Home Carer tax credit	8
• **USC:** Increase in threshold to €19,372; reduce 2.5% rate to 2%; reduce 5% rate to 4.75%.	206

[3] The weekly value of each quintile is: 1: <€265; 2: <€386; 3: <€507; 4: <€658; and 5: >€658.

[4] This includes the impact by family status. Analysis of the impact on people with disabilities or ethnic minorities or gender is not technically possible at present. Future developments may rectify this.

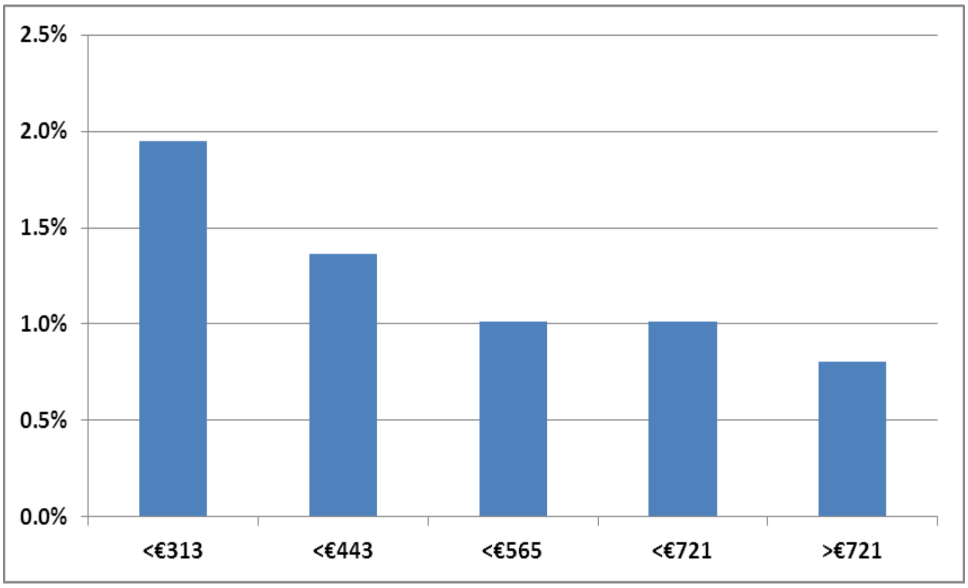
Distributive impact of the Budget 2018 measures

Based on the SWITCH model, the gain in average household disposable income as a result of the budgetary measures is 1.1 per cent, the equivalent of €11.40 per week. In all, 98.5 per cent of households benefit from the Budget, though the percentage is slightly lower in the bottom quintile (93.8 per cent).

Diagram 1 shows the distributive impact as measured by percentage change by disposable income quintile. The greatest gains are for the lowest income quintile at 1.9 per cent, followed by the second lowest quintile at 1.4 per cent. The third, fourth and fifth quintiles gain slightly below the average, at around 0.8 to 1 per cent.

Diagram 1: Distributive impact of the composite 2018 measures

(Percentage gain in household income by equivalised disposable income quintile)



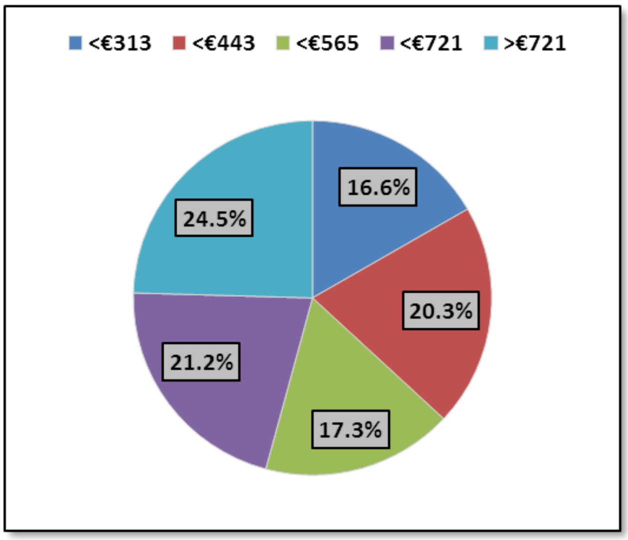
Source: DEASP analysis based on SWITCH, the ESRI tax-benefit model

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

- The largest contribution goes to the top quintile at 24.5 per cent.
- The fourth quintile receives 21.2 per cent of the expenditure.
- The bottom, second and third quintiles get 16.6, 20.3 and 17.3 per cent respectively of the estimated expenditure.

Diagram 2: Distribution of aggregate expenditure

(Percentage contribution by equivalised income quintile)



Source: DEASP analysis, based on 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 €306.3 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 85 per cent paid in 2016. The income tax measures have the largest net cost at €586.4 million. In turn, these have the greatest impact, with an average household gain of 0.7 per cent.

Table 2: SWITCH estimate of net cost and impact of the tax and welfare component measures in Budget 2018[7]

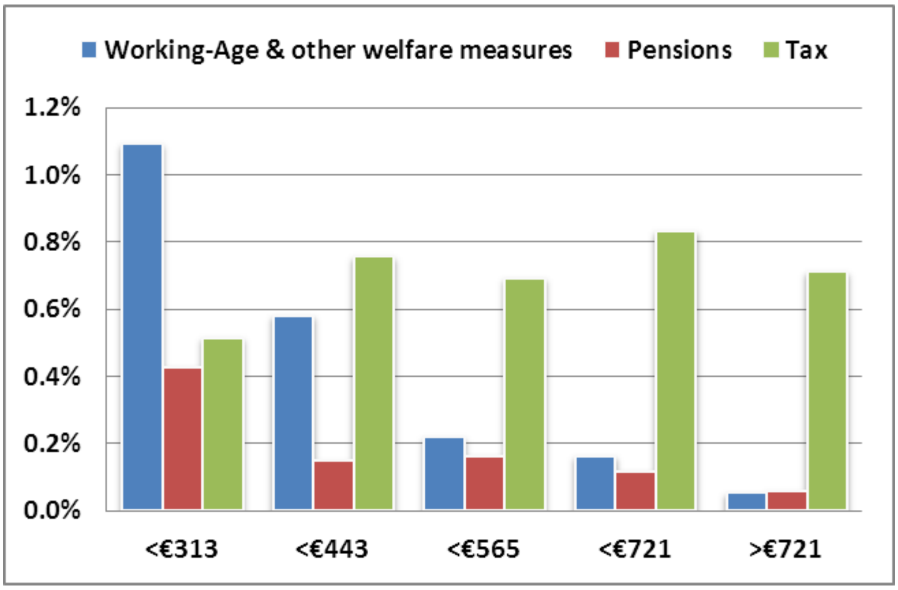
Measure	Net cost	Impact
Social welfare	€306.3m	0.4%
Income tax	€586.4m	0.7%

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. qualified child increases, lone parent disregard and Christmas Bonus), the gains are concentrated in the bottom two income quintiles (1.1 and 0.6 per cent respectively). The weekly rate increase for pensioners resulted in above average gains in the bottom and third quintiles (0.4 and 0.2 per cent respectively.

The income tax measures are most beneficial to the second and fourth quintiles (0.8 per cent), with average gains for the third and top quintiles.

Diagram 3: Distributive impact of the main Budget 2018 components
(Percentage gain in household income by equivalised income quintile)



Source: DEASP analysis, based on SWITCH, the ESRI tax-benefit model

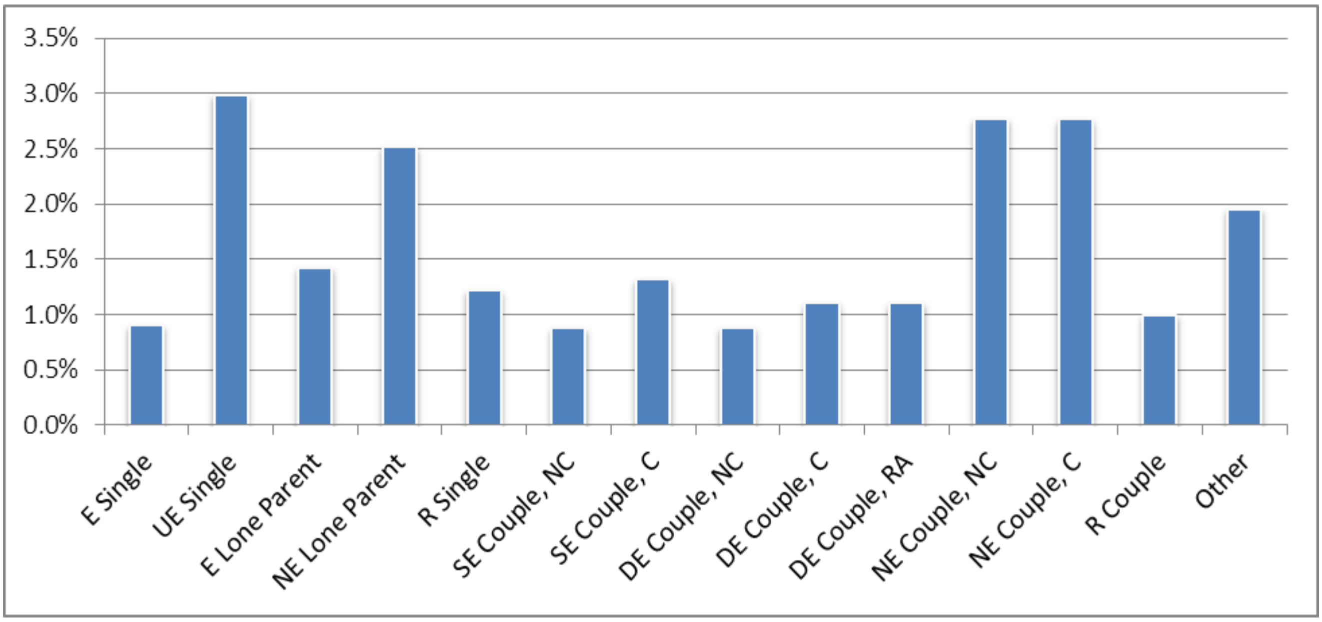
[7] The SWITCH costings differ from the official figures due to the Christmas Bonus, the impact of any tax or welfare offsets (e.g. any tax paid on increased welfare rates) and as not all beneficiaries of the rate increases are captured in the model.

Impact on family types

Diagram 4 presents the distributive impact of the composite 2018 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 (2.5 per cent), non-earning couples with and without children (2.8 per cent), and unemployed singles (3 per cent).
- Other family types [ix] see a gain of 2.0 per cent, again above the average of 1.1 per cent.
- Employed lone parents, single earner couples with children and retired singles have gains slightly above average (1.4, 1.3 and 1.2 per cent respectively).
- Dual earner couples with children receive average gains of 1.1 per cent while both single earner and dual earner couples without children gain slightly below average at 0.9 per cent.
- The remaining households also see income gains as a result of Budget 2018, but at lower than average rates.

Diagram 4: Distributive impact on families of the composite 2018 measures
(Percentage change in income by family type)*



Source: DEASP analysis, based on 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 disposable income increases by 0.9 per cent as a result of the Budget measures. Despite this, the population at-risk-of-poverty falls by 0.6 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 2018 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] A replacement rate of ≤ 70 per cent indicates a strong financial incentive to work.

Looking at the overall distribution of replacement rates, the model shows that the majority of people at work (87 per cent) have strong financial incentives to work. This is an increase on the 2017 figure of 85 per cent. For those who are unemployed and receiving a jobseeker payment, the rate has increased to 84 per cent from the 2017 figure of 82 per cent.

Marginal Effective Tax Rate

The Marginal Effective Tax Rate (METR) measures 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 2018, 25% of the working population should experience a reduction in their Marginal Effective Tax rate (METR) while there should be little to no impact on the METR for a further 69% of the working population. Only 6% of the working population should experience any increase of their Marginal Effective Tax rate.

Distributive impact of increases in the national minimum wage [10]

The average gain from the increase to the national minimum wage is negligible at 0.07 per cent.[xi] The second and fourth quintiles show above average gains of 0.12 and 0.10 per cent respectively.

[10] To analyse the potential impact of a change in the national minimum wage, SWITCH simulates it for the 2017 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 2018 compared with Budget 2017

Finally, the distributive impact of the budgetary package for 2018 is compared with the 2017 policy – see **Diagram 5**. The average gain in 2018 is 1.1 per cent. This compares to 1 per cent in 2017.

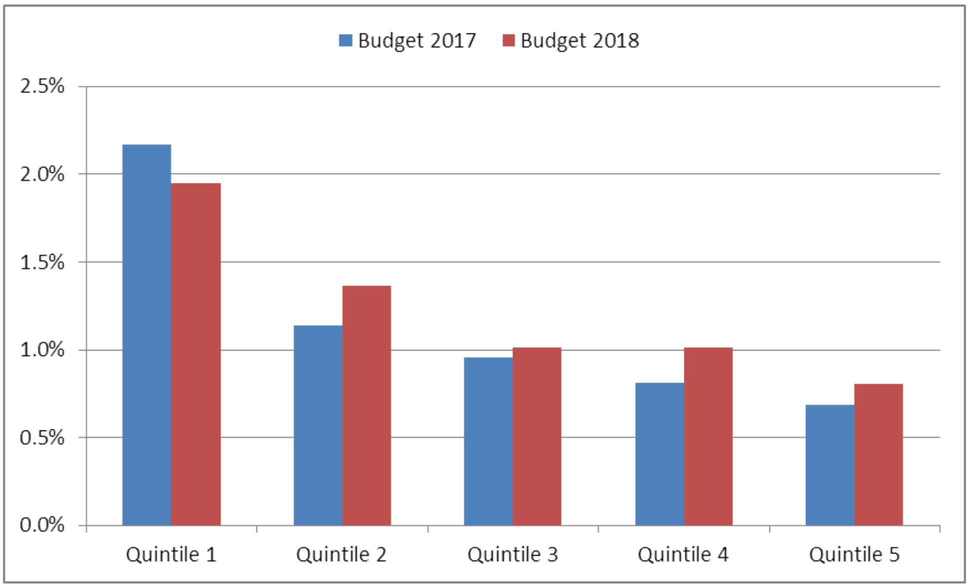
Budgets 2017 and 2018 benefit all income quintiles but in different proportions. Budget 2018 reflects the approach of the previous year with modest increases across the board combined with some more targeted measures.

The bottom quintile gains slightly less in Budget 2018, compared to Budget 2017, with the remaining quintiles gaining slightly more.

Budget 2018 has a strong progressive pattern with the bottom quintile gaining 1.9 per cent, nearly 2.5 times the gain of the top quintile (i.e. 0.8 per cent).

Diagram 5: Distributive impact of Budget 2017 and Budget 2018

(Percentage gain in household income by equivalised income quintile)



Source: DEASP analysis, based on SWITCH, the ESRI tax-benefit model

References

[i] Published budget documentation includes preliminary information on the distributional effects of the Budget 2018. 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; http://www.finance.gov.ie/what-we-do/tax/the-tax-strategy-group/; http://budget.gov.ie/Budgets/2018/2018.aspx.

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

[iii] See: www.equalitybudgeting.ie

[iv] 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

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

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

[vii] 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/

[viii] Seehttp://www.welfare.ie/en/Pages/Budget-2018.aspx and http://budget.gov.ie/Budgets/2018/2018.aspx

[ix] 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.

[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 Callan T, and Logue, C. (2016) *Low Pay, Minimum Wages and Household Incomes: Evidence for Ireland,* Dublin: ESRI for more analysis on this topic at: www.esri.ie/pubs/BP201703.pdf