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Analysis of Budget 2001

[Budget 2001 marked a significant shift in terms of income distribution from previous Budgets. Average improvements of 4 percent were achieved across all income groups, though differences in absolute gains remain considerable. There was however little change in the percentages experiencing relative income poverty.]



1. INTRODUCTION

The Agency has prepared and published this commentary on the implications of the 2001 Budget for poverty reduction in accord with its statutory policy advisory and public education roles. It compliments our submission to the Minister for Social, Community and Family Affairs on the policy priorities for Budget 2001.¹ This assessment of Budget 2001 is set against a government policy commitment that the benefits of economic growth will be shared fairly among the population, as outlined in the *National Anti-Poverty Strategy, the Action Programme for the Millennium and the Programme for Prosperity and Fairness*.

Reflecting this policy commitment, Budget 2001 has as an explicit policy objective the promotion of a fairer society. In addition, fairness is a theme underlying the other budgetary objectives: improving quality of life, rewarding work and enterprise and securing economic prosperity. Furthermore, the Budget was poverty proofed² in advance and the results disseminated by the Departments of Finance and of Social, Community and Family Affairs on their respective tax and welfare elements. This is in keeping with the proposals from the NESF for a comprehensive poverty proofing of the Budget and a greater transparency in its application.³

A key analytical tool informing this commentary is the Agency's use of the ESRI tax/welfare model (SWITCH).⁴ SWITCH greatly enhances our ability to comprehend the distributive implications of Budget 2001, as it is based on a representative sample of households and reflects the combined impact of tax and welfare changes.

The commentary begins by taking a macro-economic perspective on Budget 2001. This is followed by an examination of the distributive and poverty-reduction effects of the Budget. Specific aspects of the Budget are then considered: social welfare, child income support and taxation. There is also a discussion of the special savings incentive scheme which the government announced as part of the Finance Bill. The analysis concludes with some policy issues for consideration in Budget 2002.

2. MACRO-ECONOMIC PERSPECTIVE

Budget 2001 is set against a macro-economic background of rapid economic growth, rising inflation and wages and emerging labour market shortages. It is widely predicted that our capacity for rapid growth is now coming to an end and the challenge for the next few years is to ensure a planned slowdown. The scale of the Budget package - £2,000 million plus a further £2,500 million in public expenditure - raises the danger that the economy will overheat. The boost given to high earners through tax rate cuts can be singled out as likely to encourage consumption. The negative implications of this investment boost to the economy on inflation are of particular concern for welfare recipients. Also, it is likely to increase housing costs, which will be especially to the detriment of those on low/middle incomes, such as first-time home buyers and renters in the private housing sector.

Against this, the Budget contained a number of inflation-reduction measures: cuts in VAT and excise duty and tax inducements to encourage savings. However, such reductions may be of a temporary nature. The reductions in income tax may dampen wage demands directly and have an indirect influence by increasing labour market supply, leading to reduced upward pressures on inflation for 2001. Similarly, increased investment in childcare may lessen the spiralling costs associated with this service, though this can have a long lead-in time.

Overall, economic growth is expected to decline from 8.6 per cent in 2000 to 6 per cent in 2001. Inflation is estimated to fall to 4.5 per cent for 2001, a significant drop on the forecast rate for 2000, 5.6 per cent. Employment is expected to increase by 2.5 per cent, leading to a further fall in the numbers registered as unemployed.

With a tax/welfare allocation of £2,000 million, Budget 2001 represents an increase of £400 million or 25 per cent on last year. This increase is all accounted for on the welfare side, with expenditure doubling from £400 million to £850 million in 2001. Consequently, the welfare component in the Budget increases from a quarter last year to 40 per cent. Despite this growth, the government finances are set to continue to improve in the aftermath of Budget 2001. The increased expenditure announced in the Budget on tax/welfare measures, public services and public sector wages, are more than balanced by lower debt repayment costs and buoyant tax returns. Consequently, the exchequer surplus is forecast at £2,500 million in 2001, while the debt to GDP ratio will decline to 33 per cent. In addition, resources continue to be set aside for the reserve fund to meet future pension costs which now exceeds £5,000 million.

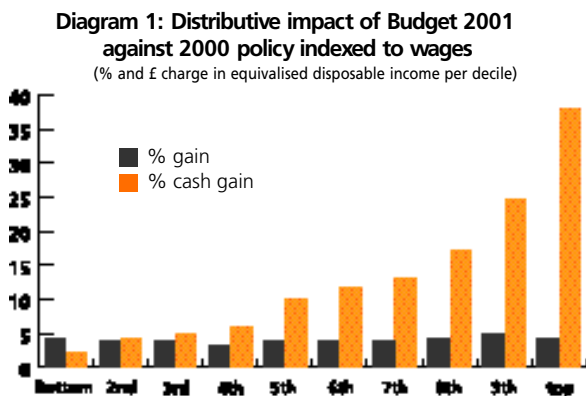
3. DISTRIBUTIVE AND POVERTY IMPACT

A distributive analysis of Budget 2001 is framed by the overall distribution of income in society.⁵ The gap is greatest at the extreme: 3.6 per cent of income for the poorest 10 per cent of the population as against 24.3 per cent for the richest, a ratio of 1:7. Inequality of income is reflected across all decile groups, with the bottom six deciles getting a disproportionately smaller share of income and the richest four deciles getting more than their share. In overall terms, the bottom sixty per cent of households account for just over a third of all income. By contrast, the most affluent 40 per cent of households have two-thirds of total income. In a comparative context, Ireland is one of a group of EU countries with relatively high inequality. Furthermore, income inequality has worsened since 1994 as the share going to poorer households has fallen by almost 1 per cent. In part this reflects the market effect of rapid employment and wage growth. It also is due to the fiscal policy informing recent Budgets, which has given precedence to tax reductions over welfare improvements. For example, better-off households gained four times more than poorer households in Budget 2000, reflecting the lion's share of resources allocated to tax cuts.

In assessing the distributive impact of Budget 2001, there are three important issues:

1. First, the traditional means of analysis of budgetary impact - case studies or specimen incomes - is unrepresentative of the population at large. A simulated representative sample is required to assess the overall outcome of budgetary policies.⁶
2. Second, analysis of the Budget cannot be based on a no-change tax and welfare scenario, as this is unrealistic and potentially misleading.⁷ Adjusting tax and welfare policies to take account of wage growth provides a neutral benchmark for assessing the distributive effects of the Budget. (The cost of this benchmark is £750 million, a third of the amount spent in Budget 2001.)
3. Third, the distributive analysis should distinguish between percentage and actual increases. Percentage increases are significant because they reflect the value of Budget changes relative to existing incomes and allow the impact on overall income distribution to be identified. Absolute gains indicate how much different income groups secure in straightforward cash terms. It also reveals how the total budgetary allocation is shared out among the population.

We now turn to the impact of Budget 2001 as outlined in Diagram 1:



- The average percentage gain is 4 percent, as compared to a 2000 policy indexed by wage growth. Significantly, this improvement was broadly achieved across all income groups, though middle income groups did relatively less well, and the richest deciles gained slightly more than the norm.⁸
- This pattern contrasts sharply with Budget 2000 (and indeed previous Budgets throughout the 1990s), when better-off households gained four times more than poorer households did. Last year, the average gain for the bottom fifth of households was 1 percent, the incomes of households in the 3rd to 7th deciles grew by 2-3 percent, while the richest households were 4 percent better-off.
- The average cash gain per tax unit is £13.12. However, the range of cash gain is quite wide, with a spread from £2.17 per week for those in poorest decile to £37.90 for the richest, a ratio of 1:17;
- Reflecting the differences in absolute gains, there is an uneven distribution of total budget resources, with the

richest 10 percent receiving 29 percent of allocated monies, as compared to less than 2 percent for the poorest decile. In overall terms, 60 percent of Budget resources was received by the richest 30 percent of the population.

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It is also useful to assess the impact of Budget 2001 on different types of families, especially as the Budget contained a strong emphasis on children. Table 1 reveals that the greatest percentage gains were indeed recorded by households with children, whether in or out of work, single or dual earner or one or two parents. Non-earning couples with children recorded the highest increase at 8 percent. This picture changes however when focusing on actual cash gains. Here we find that it is working households who benefit the most rather than those with children, with double earner couples with children recording the highest gain: £37.28, almost three times the norm. The category recording the highest percentage increase - non-earner couples with children - secure an improvement of £17.10, which is a third more than the norm.

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[The most recent data for income poverty rates are for 1998.⁹ These reveal that a fifth of the population falls below a poverty line set at 50 percent of average income. Other poverty thresholds give the following results: 9.6 percent below 40 percent of average income and 30 percent below 60 percent of average income]

Table 1: Distributive impact of Budget 2001 by family type against 2000 policy indexed to wages (% and £ gain in equivalised disposable income)

Family type	% gain	£ gain
Single employed, no child	4.0	10.31
Single, unemployed, no child	1.7	1.23
Employed lone parent	5.1	15.25
Non-earning lone parent	5.9	7.92
Single retired	2.9	3.73
Single earner couple, no child	2.7	15.59
Single earner couple, child	4.2	22.24
Dual earner couple, no child	4.3	28.63
Dual earner couple, child	5.4	37.28
Dual earner couple, relative assisting	3.5	21.76
Non-earner couple, no child	3.8	5.41
Non-earner couple, child	8.0	17.10
Retired couple	2.7	7.14
Other	2.8	1.91
Average	4.1	13.12

Finally, we can look at the impact on Budget 2001 on income poverty. The most recent data for income poverty rates are for 1998.⁹ These reveal that a fifth of the population falls below a poverty line set at 50 percent of average income. Other poverty thresholds give the following results: 9.6 percent below 40 percent of average income and 30 percent below 60 percent of average income. This is a snapshot picture and should be seen in

the context of trends over time. Here, we see that the percentage of people below the 50 percent poverty line is largely unchanged since 1994. Deterioration is evident at the 40 percent line, where the percentage has grown by a half. Only at the 60 percent threshold has the percentage fallen (down 3 points).¹⁰

The SWITCH model allows us to calculate pre and post Budget 2001 poverty rates, along with the depth of income poverty (table 2).¹¹ This reveals that the rate of poverty will remain high after Budget 2001, varying between 9 and 27 percent depending on the cut-off point. More importantly, income poverty will drop only marginally as compared with what would have happened if the 2000 policy were indexed by wages. There will be an equally minimal change in the depth of poverty. Thus despite allocating treble the amount in Budget 2001 as would have been required by a simple indexation of tax and welfare policy, the impact on relative income poverty is marginal. This reflects two factors: first, the higher expenditure results in an increase in average incomes and therefore the various poverty lines; second, the additional resources allocated are not particularly well targeted. It is evident, therefore, that reducing poverty will require a more targeted approach to income redistribution, with a prioritisation of those dependent on welfare.

Table 2: Relative income poverty lines and income poverty gap post-Budget 2001 compared to 2000 policy indexed by wages ¹²

Poverty line	Head count		Poverty gap	
	Budget 2001	Change	Budget 2001	Change
40%	9.1%	- 0.3%	1.3%	- 0.2%
50%	20.4%	+ 0.1%	4.1%	- 0.1%
60%	27.2%	- 0.2%	7.4%	no change

It is interesting in the light of this analysis to review the results of the poverty-proofing procedures undertaken in relation to Budget 2001. First, it is apparent that undertaking separate poverty-proofing reviews of the welfare and tax changes gives incomplete information as to the overall effects of the Budget. Thus, while the review of the welfare improvements carried out by the Department of Social, Community and Family Affairs reveal that low income households benefit most it does not factor in the tax changes which cost 1.5 times the welfare component. Similarly, the poverty-proofing review conducted by the Department of Finance primarily focuses on tax elements of the Budget, though it also includes the child benefit and FIS changes (giving rise to separate issue of double counting). Second, the data sources used to inform the reviews are quite different. The welfare review is informed by the SWITCH model. By contrast, the principal data source for the tax review is examples based on various categories of taxpayers over a range of specimen incomes, with the SWITCH model only used as a secondary source. Third, there is no reference to other factors influencing incomes, notably inflation and wage growth. Rather, both reviews assume a no-change scenario, which is not in accordance with economic trends.

Three other points should be noted. The impact on poverty and income distribution is but one criterion for assessing the Budget.

Broader social and economic policy objectives are also relevant to the Budget, especially from a tax perspective. It is not intended that poverty proofing requires that all policies be transformed so that they are explicitly targeted at the disadvantaged. Second, the Budget can have indirect effects on poverty and income inequality by encouraging the take-up of employment or by enhancing service provision. The SWITCH analysis presented above does not measure the impact on work incentives or services. The Budget contains a number of features which are likely to increase incentives, especially for those on low incomes (i.e. increases in child benefit, family income supplement and personal/PAYE tax allowances). Finally, since the tax burden is primarily carried by better-off households, reductions in taxes will in general benefit these groups more than others. This highlights the limitations of a tax-driven approach to income distribution no matter what instruments are selected. A redistributive policy must therefore combine tax and welfare reforms in a coherent strategy. An example of this in Budget 2001 is child income support policy, where child benefit was chosen over tax reliefs.

4. SOCIAL WELFARE

Budget 2001 provides for welfare increases of between £8 and £10 per week, double the level of increase in Budget 2000. In percentage terms, these increases represent an indexation of between 10.5 and 12 percent on 2000 figures, which can be compared to a forecast inflation rate of 4.5 percent. More significantly, the rate of increase is in excess of wage increases of 7.8 percent in 2000. The government's rationale for this above average increase is twofold: first, to compensate welfare recipients for the higher than expected inflation rate in 2001 and, second, to link welfare payments with average wage growth rather than just the expected inflation rate.¹³ Explicitly indexing welfare payments with wage increases is a significant policy departure, which sets a major precedent for future budgetary policy. However, there is some debate about how

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exactly wage growth should be defined and whether it should be based on a gross or net (i.e. after-tax) calculation. Greater clarity as to the definition of wage growth would be a welcome development and perhaps could be taken up by the working group examining the benchmarking and indexation of welfare payments.

The Agency had recommended a minimum welfare increase of £8 per week. However, it had also proposed as a separate inflation compensatory measure the bringing forward of welfare increases to the start of 2001. This was not feasible for administrative reasons, though compensation could still be provided through a lump sum payment later in the year, similar to the Christmas bonus. There is also a precedent for such a measure as part of the renegotiated wage agreement under the *Programme for Prosperity and Fairness* (equivalent to 1 percent of pay). The possibility of linking such a lump sum welfare payment with participation in the government's special incentive savings scheme is considered later in the analysis.

The emphasis on providing a flat rate increase is a welcome approach as it favours those on the lowest welfare payments. It also keeps the government on course to meet its commitment to provide a minimum £100 per week welfare payment by 2003.¹⁴ Given the scale of resources available and the largesse provided in tax reductions, there was scope to have given a higher payment, such as provided for pensions. Indeed, the higher payment for pensions means the differential with other welfare payments continues to widen. This cannot be justified on the grounds of living costs.

There were a number of important structural reforms in Budget 2001:

- Bringing forward payment of welfare increases to the start of the tax year (child benefit improvements will still lag behind, though the time lag is narrowed to three months by the introduction of increases in June instead of September);
- Higher payments for adult dependant allowances, in order to increase the percentage value from 60 percent to 65 percent of the adult personal rate. The increase is even greater for certain older dependants, where the goal is to equalise adult dependant payments with the rate of the old age pension (non-contributory). This will result in the administrative individualisation of these payments;
- Wider eligibility for various means-tested and age-related welfare schemes, including the Carer's Allowance, free schemes for old age pensioners and living alone allowances for recipients of disability payments.

Examples of the increased welfare payments are illustrated below. Finally, the significant additional expenditure on social welfare in Budget 2001 should be noted: £520 million, up from £300 million last year. By far the main element of this allocation is for increases in welfare rates, at a cost of £440 million. This growth in the welfare component of the Budget has occurred while the cost of the tax reductions remains the same, thereby rebalancing the allocation as between welfare and tax.

Table 3: Selected examples of welfare increases in Budget 2001

Welfare category	Current payment	Budget 2001	Increase
Single person on SWA	£76	£84	10.5%
Unemployed couple (UA-ST + ADA)	£123 (£76 + £47)	£138 (£84 + £54)	12.2%
Pensioner couple (OAP-NC + ADA)	£137.20 (£85.50 + £51.70)	£162.20 (£95.50 + £66.70)	18.2%

5. CHILD INCOME SUPPORT

Budget 2001 announced a 50 percent increase in child benefit (£5.77 per week or £25 per month), as part of a three year strategy to almost treble the current rate to £27 per week or £117.50 per month. This represents the largest ever improvement in child benefit. At a cost of £330 million, it is over three times last year's expenditure increase. This payment increase also marks a decisive shift in the structure of child income support. Previously, child income support was split between the welfare system (child dependant allowances and family income supplement), a universal child benefit and the tax system (double tax allowances/bands and home carer's allowance), with ad hoc improvements in all three over time. This tripartite structure contained many anomalies and inequities.¹⁵ Budget 2001 has altered this structure in a fundamental way by prioritising child benefit as the mechanism for supporting families with the additional costs of children. In effect, child benefit has been mainstreamed as the main fiscal instrument for child income and represents the individualisation of tax and welfare policy as it applies to children.

Table 4: Three-year strategy for child benefit increases in Budget 2001

No of children	Current rate	2001	2002	2003
1st and 2nd	£9.81	£15.58 (+59%)	£21.35 (+107%)	£27.12 (+176%)
3rd +	£12.92	£19.85 (+54%)	£26.77 (+107%)	£33.69 (+161%)

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From an anti-poverty perspective, a key criterion in assessing child income support is its adequacy in relation to basic child-rearing needs. While child benefit is set to rise by £5.71 per week, the rates of child dependant allowances remain unchanged under Budget 2001, representing a devaluation of these payments by the rate of inflation. The combined increase for children on welfare is therefore 24 percent (as compared to 59 percent in child benefit alone).¹⁶ In terms of adequacy, the outcome is a continuing shortfall of £6.40 per week or 18 percent in regard to the minimum costs of a child (excluding childcare).¹⁷ The shortfall is even greater for older children, whose child-rearing costs are highest. A minimum living standard for children can therefore only be achieved by diverting scarce resources from meeting the needs of other household members. The gap between child support and minimum costs could have been narrowed further if the Agency recommendation for age-relating of existing child dependant rates, together with a modest overall increase, had been implemented.¹⁸ For children in larger welfare-dependant families, the shortfall is much less severe because of the supplement afforded to the 3rd + child under child benefit. Such children will receive a combined weekly equivalent payment of £34.26, which is only £2 less than the basic costs. What this deficit highlights is the continued absence of an official measure of what constitutes a minimum adequate level of income support for children. This should be addressed as a matter of urgency by the working group on benchmarking and indexation of welfare payments.

Table 5: Adequacy of child income support post-Budget 2001

Current level of support (child dependent allowance - £13.20, child benefit - £9.80, clothing and footwear allowance - £1.21)	£24.21
Gain under Budget 2001 (child benefit - £15.57)	£5.77 (24%)
Total level of support post-Budget 2001	£29.98
Basic minimum costs of a child in 2001 (including food, clothes, education, personal care, toys, holidays and household goods) ¹⁹	£36.38
Shortfall	£6.40 (17%)

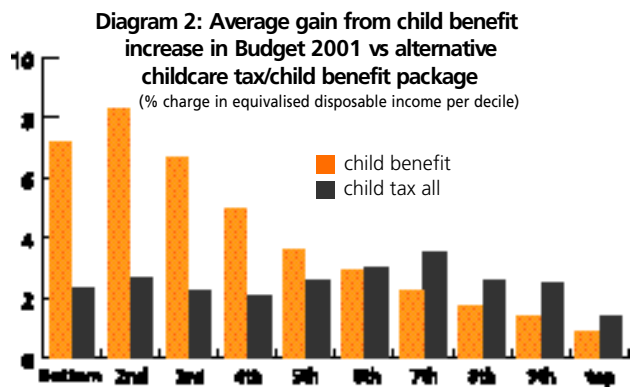
A further point to note from an adequacy perspective is the shift in the structure of child income support from child dependant allowance to child benefit. The new child benefit rate will be the weekly equivalent of £15.57, as compared to £13.20 for child dependant allowances. As households on low incomes budget on a weekly basis, this highlights the urgent necessity to convert child benefit into a weekly payment.

The priority given to child benefit in Budget 2001 also reflects the government's desire to assist all families with the costs of children, including childcare. As child benefit goes to all households with children, an important equity question is how fairly these resources are distributed across the income schedule.

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In this context, there were a number of competing options as to how the government should support childcare costs. It is useful therefore to assess the distributive effect of child benefit in comparison with an alternative childcare package. The child benefit increase is contrasted in the Diagram 2 with an alternative childcare package consisting of a purchased childcare tax allowance of £4,000 per child up to age 14 plus a more modest child benefit increase of £2/£2.50 per week, which business and trade union groups lobbied for. Both packages would cost similar amounts (c£320 million).

The SWITCH findings reveal the greatest percentage gains under the child benefit increase go to households on the lowest incomes: between 7 and 8 per cent. The percentage gain decreases as income rises, with the most affluent groups gaining less than 2 per cent. By contrast, an alternative tax-based child income package would give roughly similar percentage improvements for all deciles and therefore is far less targeted. The difference between the two packages is even more pronounced when looked at in terms of the absolute gains per week. Under Budget 2001's child benefit proposal, the gain per week varies between £9 and £13. By contrast, the alternative childcare package would confer the greatest absolute gains on better-off families. Such families would get up to £20 per week, as compared to less than £5 for low-income families. These divergent patterns are also reflected in the overall share-out of the additional expenditure: child benefit is roughly proportionate across the income deciles, with the middle fifth getting slightly more (28 percent) and the bottom fifth slightly less (15 percent); a childcare tax/child benefit package. However, only 5 percent is received by the poorest fifth, with a third going to the richest 20 percent. Childcare tax relief, despite the equalising effect of a child benefit component, clearly favours families at the upper end of the income schedule.



The impact on different family types is also important, given the policy concerns about treating all families and their means of childcare in an equitable fashion. Table 6 shows how the types of families benefiting would be quite different. The child benefit package is especially beneficial to unemployed families, both lone parents and couples with children (+ 7 to 8 percent). They also receive substantial cash gains: between £9 and £16 per week. Working families with one earner would also gain above the average (£13.2 per week). Meanwhile, the distribution of gains under the alternative package favours those already in work, in particular dual earning couples. Single earner couples would gain the least, reflecting the focusing of relief on purchased rather than home-based childcare. These differentials are greatly magnified when focusing on cash gains (£27 per week for dual earners, compared to less than £5 for all categories). In terms of the overall pot of resources, a massive 75 percent (£242 million) goes to dual earners with children. The comparable figure under the Budget 2001 child benefit package is 32 percent (£101 million).

This analysis shows how equitable child benefit is as an income support. By contrast, a tax-based approach would primarily benefit better-off families. There are other social equity reasons for favouring child benefit: it avoids the unemployment and poverty traps associated with means-tested child payments; it has a high take-up; it is paid to mothers as the primary carer and it promotes horizontal equity between households on similar income levels.

Table 6: Average gain from child benefit increases in Budget 2001 Vs alternative child care tax/child benefit package by family type (% change by equivalised disposable income)

Family type	Budget 2001	Alternative
Employed lone parent	3.3%	1.1%
Non-earning lone parent	6.9%	2.2%
Single earner couple, child	2.5%	0.9%
Dual earner couple, child	1.7%	4.0%
Dual earner couple, relative assisting	1.7%	3.0%
Non-earner couple, child	8.1%	2.6%
Retired couple	3.3%	1.1%
Other	7.4%	2.4%
Average	2.4%	2.4%

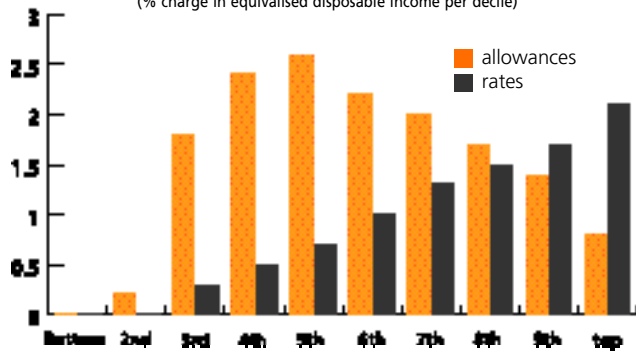
Another childcare proposal was the introduction of a taxable parental childcare payment. In effect, this is quite similar to child benefit as a universal payment, except that it would be clawed back from better-off families (by increasing their tax burden). This is not modelled here, as it is not significantly different from what Budget 2001 proposes. Furthermore, the rationale for taxing child benefit is questionable in an era of surplus public resources and a political commitment to tax reductions. It also is more transparent to build on the existing and very popular system of child benefit rather than introducing a separate and potentially confusing scheme. The key focus should be on helping families with the additional costs of children, while leaving parents the choice as to how these resources are allocated in the best interests of their children.

In this context, it is worth recalling that the child benefit option for supporting families' childcare costs was supported by two major government policy reviews: the Commission on the Family and the Childcare 2000 Expert Working Group. Both emphasised the advantages of child benefit in its neutral treatment of different types of families and in giving parents the choice as to how resources are used. The one off-putting issue in regard to child benefit was the cost of an adequate rate of payment (estimated at £20 to £30 per week). However, Budget 2001 has now made the required scale of increase an attainable goal over three years for all children. One concern from a childcare perspective is that the child benefit increase was not age-related, i.e. giving more for the care of younger children. This argument clearly has validity, but should be balanced by the previous argument from a child poverty perspective that older children cost more in direct costs. It would have been unfair to have given a supplement for the care of younger children while not recognising the higher costs of older children on welfare. Finally, it is disappointing that Budget 2001 did not introduce any additional childcare measures for low-income groups, as had been recommended by the Agency, to meet particular employment and educational needs, i.e. a childcare disregard under family income supplement and a means-tested pre-school allowance.²⁰

6. TAXATION

The taxation element of Budget 2001 amounted to £1,200 million, similar to last year. The choice of tax reduction measures was somewhat different to the 2000 Budget in that the main focus was on personal and PAYE allowances. These were increased by £800 (£1,600 for a couple) and £1,000 respectively, at a cost of £530 million. However, Budget 2001 did maintain continuity with previous years with the decision to cut the standard and higher rates of tax (by 2% in both cases, reducing the rates to 20% and 42% respectively), at a cost of £371 million. The Agency has previously outlined its concerns about the necessity for and the unequal outcome of such rate cuts. The distributive impact of the reduction in the basic and top tax rates is outlined in Diagram 3, as compared to a similar costing option of increasing allowances.

Diagram 3: Average gains from cuts in tax rates Vs increases in personal/PAYE allowances
(% change in equivalised disposable income per decile)



The main beneficiaries of tax rates reductions are higher earners. There is a steady increase in gain from the third decile (0.3 percent) to the top decile (2.1 percent). This pattern is reflected in the total allocation of resources, with the richest fifth of the population accumulating 65 percent. An alternative strategy whereby a similar amount is allocated to personal allowances has a quite different effect, with the primary beneficiaries being middle income groups. Thus, the third to seventh deciles would all get a minimum 2 percent increase in incomes, with a reducing gain as we move up the income schedule, (0.8 percent for the richest decile). The share-out of resources is less top-heavy: 26.5 percent for the middle fifth deciles as compared to 38 percent for the highest fifth.

While tax allowances are more progressive, four caveats can be noted. First, the lowest income deciles gain nothing as they have insufficient income to benefit from tax reductions. An additional welfare payment would be needed to ensure that low-income households are not excluded from the benefits of tax give-aways. Second, the need for further tax reductions, as compared to an alternative of investing the resources in public services and infrastructure, must be questioned. Given the growing concerns about a deterioration in the quality of life, in

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particular in health, housing and transport, a better value-for-money option would be to put spare resources into these services. Third, the inflationary effects of excessive tax reductions may be counterproductive to economic growth, especially in regard to house prices. This point has been made by the European Commission among others. Finally, the continuing fall in the tax-take as a share of GNP arising from the enormous scale of tax reductions in recent Budgets may leave the economy exposed when current record levels of economic growth come to an end. This threat is highlighted by the fact that Ireland already has among the lowest tax take of EU countries: 34 percent as compared to a European norm of 43 percent.

The government continued with its policy introduced in Budget 2000 of individualising the tax system by restricting the transferability of tax bands. The Agency is on record as favouring this approach, but only as part of a co-ordinated strategy to improve child income support for all families. This strategy is apparent in Budget 2001 with the £25 monthly rise in child benefit and resulted in a more benign public reaction to tax individualisation in this year's Budget.

There are some other tax changes which are noteworthy from a poverty perspective. The government made a number of changes to PRSI. One of these is to lower the rate of employee PRSI, from 4.5 percent to 4 percent. In recent years, the rate of employees PRSI has fallen by a quarter. The Agency is concerned at the long-term effects of such a significant lowering of the

[The government continued with its policy introduced in Budget 2000 of individualising the tax system by restricting the transferability of tax bands. The Agency is on record as favouring this approach, but only as part of a co-ordinated strategy to improve child income support for all families. This strategy is apparent in Budget 2001 with the £25 monthly rise in child benefit and resulted in a more benign public reaction to tax individualisation in this year's Budget]

PRSI rate for the financial viability of the social insurance system. Furthermore, the current surplus resources in the PRSI fund should be seen as an opportunity to widen the range of benefits provided, which is currently very rudimentary. In particular, there is scope to increase the provision of medical and dental benefits, including perhaps a free GP service. Cutting the rate now, while leaving the ceiling untouched, was a missed opportunity to make the structure of employee PRSI more progressive.

Interestingly, such a reform was introduced for employer PRSI, with the abolition of the income ceiling. This is a very progressive measure and addresses a major inequity in the rate structure. It also enhances the resources available to the PRSI fund, therefore compensating for the cut in employee PRSI. This change in employer PRSI will also claw-back the huge gains accruing to business from the ongoing reduction in corporation tax towards the target rate of 12.5 percent. Budget 2001 also announced some reductions in capital taxation. With evidence of increasing accumulation of wealth in this country, the policy implications of these changes on income distribution are potentially negative. Strengthening such taxes should be the policy focus. The introduction of tax relief on contribution to home-based charities is welcomed, though at the cost of contracting the tax base.

7. SCHEME TO ENCOURAGE SAVINGS

The Finance Bill, which implements the tax changes in Budget 2001, also contains provision for the introduction of a special savings incentive scheme. This scheme is designed to encourage savings, with a secondary goal of curbing potentially inflationary personal expenditure (which ironically seems likely to occur given the scale and focus of the tax reductions in the Budget). In principle, this measure could be of considerable benefit to low-income households who frequently find it difficult to build up savings. However, unless the specific circumstances of such households are taken into account in the design of the scheme, it is likely that this potential benefit will be lost. There are two main drawbacks to the scheme from an anti-poverty perspective.

First, better-off households are set to gain more from the scheme than those on a low income. Given that people's capacity to save is mainly influenced by their income levels, better-off households who can afford to save more will get a higher government subsidy. Even if households were to put their gain from Budget 2001 (after indexing by wages) into the scheme, the poorest decile would have £10 per month to invest against £170 for the richest decile. Given the flat 25 percent rate of subsidy, Table 7 shows the amount of subsidy for different levels of savings. Thus, the maximum saver will get £3,000, twenty times that received by the minimum saver (£150). The impact of this differential gain from savings on income distribution could be significant. Assuming a graduated amount of savings by income decile, the richest fifth of the population would get 36 percent of the government resources allocated to the scheme (estimated at £1,000 million), while the poorest fifth would only get 4 percent.²¹ This accumulation of resources under the scheme by the better-off is likely to be further exacerbated by higher financial returns accruing to the bigger savers and lower take-up of the scheme by low-income households.

Table 7: Total amount of subsidy under the special savings scheme

£10 per month =	£600 x 25% =	£150 subsidy
£50 per month =	£3,000 x 25% =	£750 subsidy
£100 per month =	£6,000 x 25% =	£1,500 subsidy
£200 per month =	£12,000 x 25% =	£3,000 subsidy

Given the likely imbalance in the distribution of government resources with a flat rate of incentive for all levels of savings, the Agency believes there is a good case to differentiate the rate. This could be done by frontloading the rate so that smaller savers get a proportionately higher gain, e.g. declining from 50 percent for the first £10 to 5 percent at £150+. Such a differentiation can also be justified on efficiency grounds, in that the better-off are more likely to be saving already, so the incentive should be directed at households who are least likely to save.

A second weakness of the scheme is the likelihood of a low take-up among less well-off groups. Poorer households, as those least able to save, should be a specific target of the savings scheme. However, a one-dimensional incentive savings scheme is unlikely to be sensitive to the circumstances confronting households who not only have limited surplus resources, but generally have little contact with financial institutions. These are the 'unbanked' in society, people who are excluded from financial services for a combination of personal and structural reasons.²² In all likelihood, a stand-alone savings scheme will not be seen as relevant to their specific financial needs. In order to boost the high take-up of the saving scheme among such households, a targeted approach is required which offers an integrated response to the financial needs of low-income households. The Agency proposes the following:

- Abolish or at least reduce the minimum level of savings to £5 per month and reduce the minimum length of participation to 3 years;
- Offer a savings 'voucher' of £10 to all adult welfare recipients as a start-up incentive to open a savings account and repeat this on an annual basis;
- Facilitate deductions to the savings scheme for low-income households through the social welfare system (household budget scheme), local authorities' rents scheme, training and employment schemes, Post Office 'billpay' and budget accounts operated by the money advice service in conjunction with credit unions.
- Encourage credit unions and post offices, as the two financial institutions with which low-income households are most familiar, to develop and market savings products particularly suited to this group;
- Link the savings scheme with the provision of a universal bank account, as part of the government's 'national payments strategy'. A universal account would provide access to a limited range of financial services (automatic

benefit transfer, bill-paying, cash withdrawal, affordable credit and personal pension);

- Promote the scheme among low-income groups, especially those on the margins of society (e.g. Travellers, refugees). Particular demographic categories who should be targeted under the scheme are women and young people. For women, child benefit could be used to facilitate participation in the scheme.

The Agency is also concerned that aspects of the scheme may discriminate against traditional low-income financial institutions, such as credit unions and post offices. This may arise from a) the cherry picking of the biggest savers by commercial institutions and b) the prohibition on savings being used as security for a loan.

8. CONCLUSION

Budget 2001 marked a significant shift in terms of income distribution from previous Budgets. Average improvements of 4 percent were achieved across all income groups, though differences in absolute gains remain considerable. There was however little change in the percentages experiencing relative income poverty. Overall, the even distributive impact of the Budget was achieved by enhancing the resource allocation to lower-income households – in particular welfare expenditure – rather than reducing the gains for the better-off. This is a more costly and inefficient way of distributing resources. It also has implications in terms of the differences in the absolute gains achieved and the reduction in relative income poverty. An actual redistributive fiscal strategy requires that a greater share of Budget resources is given to poorer households and less to the better-off. One way of achieving this would be to give a flat amount for all households – as with child benefit – rather than a percentage increase. The move to a tax credits system facilitates such a common approach in welfare and tax policy. It would also make budgetary changes more transparent and find support among the general public, which

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has previously expressed its concerns about growing income inequality in various opinion polls.

There is a number of progressive measures in the Budget, notably the indexation of welfare payments by wages, the increase in the adult dependant payment, the radical approach to child income support and the abolition of the ceiling for employer PRSI. The savings scheme also has merit, but much will depend on how it is adjusted to cater for low-income households. The main regressive feature is the significant

resources allocated to cuts in the rates of tax. Not alone does this explicitly favour the most well-off, it is conducive to inflation. There is also a concern about the long-term implications of reducing taxation as a percentage of GDP. While affordable now, it reduces our capacity to bring public services up to the level befitting an affluent society. There is a clear policy choice here between strategic investment which delivers a better collective quality of life and short-term tax gains which fuel private consumption among the already well-off in society.

FOOTNOTES

- 1 The submission outlined a fivefold tax/welfare strategy for income redistribution:
 - index tax and welfare payments in line with wage increases (7.6%)
 - provide additional improvements for households on the lowest welfare payments
 - target surplus resources at low and middle income households with children
 - provide an equitable system of support for the childcare costs of families
 - bring forward welfare increases, including child benefit, to the start of the year
- 2 Poverty proofing is an institutional procedure whereby policies and programmes are assessed at design and review stages as to their likely impact on poverty and related inequalities.
- 3 NESF (2000), *The National Anti-Poverty Strategy*, Opinion No 8, Dublin: NESF
- 4 As described in T Callan et al (1998), *Simulating tax and welfare changes*, Dublin: ESRI. All calculations and accompanying commentary are the exclusive responsibility of the Agency and no responsibility for the results is attributed to the ESRI or the authors of the model software.
- 5 B Nolan, B Maitre, D O'Neill and O Sweetman (2001), *The distribution of income in Ireland*, Dublin: Oak Tree Press in association with the Combat Poverty Agency
- 6 T Callan, B Nolan and J Walsh (1998), 'Income tax and social welfare policies', in T Callan (ed), *Budget perspectives: proceedings of a conference held on 27 October 1998*, Dublin: ESRI
- 7 Ibid
- 8 The adult equivalent disposable income for each decile is as follows: 1st <= £83, 2nd £83 <=£92, 3rd £92 <= £110, 4th £110 <= £139, 5th £139 <= £182, 6th £182 <= £222, 7th £222 <= £265, 8th £265 <= £315, 9th £315 <= £387, 10th > £387.
- 9 R Layte et al (2000), *Monitoring poverty trends: results from the 1998 Living in Ireland Survey*, Working paper 132, ESRI
- 10 A quite different picture is revealed by an alternative income and deprivation measure of poverty. Under this definition, between 3.5 and 8.2 percent of households were poor in 1998, reflecting a significant decline across most income thresholds since 1994.
- 11 Depth of poverty refers to the gap between a poverty line and the income of those below the line.
- 12 The average weekly household equivalent income for the 2000 policy is £241.33, giving a cash equivalent for the various poverty lines of £96.53 (40%), £120.66 (50%) and £144.80 (60%). For Budget 2001, the average figure is £251.46, with the various poverty lines being £100.58, £125.73 and £150.88. For comparative purposes, the lowest social welfare rate post Budget 2001 will be £84.
- 13 '(welfare) increases are explicitly designed to keep pace with increases in average earnings, not just inflation', Dermot Ahern TD, Minister for Social, Community and Family Affairs, *Irish Times*, 12/1/2001
- 14 An argument can be made that the £100 target figure is subject to upward review or speedier implementation in the light of higher than expected inflation and more rapid economic and wage growth than forecast when the *Programme for Prosperity and Fairness* was being negotiated.
- 15 M Plumb and J Walsh (2001), 'Child income support: options for policy reform', *Budget Perspectives. Proceedings of a conference held on 19 September 2000*, Dublin: ESRI
- 16 For beneficiaries aged 19 to 22 of child dependent allowances there is no benefit at all.
- 17 C Carney et al (1994), *The cost of a child. A report on the financial costs of child-rearing in Ireland*, Dublin: Combat Poverty Agency.
- 18 £16 per week for under 12s and £19 perweek for 12 and over. Figure indexed by inflation from original calculation by Carney et al, *ibid*
- 19 Figure indexed by inflation from original calculation by Carney et al, *ibid*
- 20 Combat Poverty Agency (2000), *Public subvention of childcare: an anti-poverty perspective*
- 21 These calculations are based on average savings of £100 per month by half the adult population. It assumes graduated savings from £10 to £190 per month from poorest to richest decile.
- 22 E Kempson and C Whyley (1998), *Understanding and combating financial exclusion*, Bristol: Policy Press. See also British Government report on access to financial services as part of its national strategy for neighbourhood renewal (Policy Action Team 14, HM Treasury, November 1999)

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