

*action on*

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# POVERTY TODAY

## Supplement

# Analysis of Budget 2006



Combat Poverty  
Agency

*working for a  
poverty-free Ireland*

This analysis examines the tax/welfare measures introduced in Budget 2006 and assesses their impact on income distribution and poverty.<sup>1</sup> It is designed to inform and advise on public policy-making on poverty, in accordance with Combat Poverty's statutory remit. In particular, it seeks to inform the assessment of the poverty impact of budgetary policy, which is an explicit requirement under the National Anti-Poverty Strategy. (A poverty impact assessment of the income tax measures in the budget is carried out by the Department of Finance and included in the budget day documentation.) The analysis complements the submission made by Combat Poverty in advance of the budget, and focuses on the key issues raised in that submission.

This analysis contrasts with the standard commentary on the tax/welfare budgetary changes for various hypothetical families. The latter approach cannot fully examine how budget measures impact on the diversity of households in the population, both

in terms of household composition and level of income. By contrast, this analysis uses a micro-simulation model (SWITCH) to examine the effect of budgetary welfare and tax changes for a national representative sample of households.<sup>2</sup> Furthermore, a key component of our application of the SWITCH model for budget analysis is to compare the policy outcomes by reference to a 'neutral' budget whereby tax and welfare rates are indexed in line with wages.<sup>3</sup> This is an important difference to the approach adopted by the Department of Finance in its use of SWITCH to assess the poverty impact of the budget. Finally, the focus on the first-round impact of budgetary changes is based on the technical assumption of no change in behaviour.

The analysis also examines the approach on relevant social welfare, child support and taxation policies in Budget 2006 from a poverty perspective, in particular where they relate to the key objectives set out in the National Anti-Poverty Strategy.

<sup>1</sup> This analysis was prepared by Jim Walsh, Head of Research and Policy, Combat Poverty.

<sup>2</sup> Tax-welfare models provide a comprehensive assessment of the effects of tax/welfare changes, taking into account the wide diversity of individual and family circumstances relevant to tax liabilities and welfare entitlements. The SWITCH tax/welfare model has been developed by the Economic and Social Research Institute based on a nationally representative sample of households. For further information on the model and its use as a tool for analysing tax/welfare policy, see T. Callan et al. (2001), *Reforming Tax and Welfare*, Dublin: Economic and Social Research Institute.

<sup>3</sup> In considering the distributive impact of Budget 2006, the first task is to establish an appropriate comparator. The standard approach is to examine budget changes against a backdrop of no policy change, i.e. welfare and tax rates are frozen in nominal terms based on the previous year's budget. This is misleading in that it assumes a starting point of losses in real income as a result of inflation, while taxes rise as wages increase. An alternative approach is to measure change using a 'distributionally neutral' budget, whereby all sectors of the population share equally in the benefits of economic growth. One such benchmark is to index tax and welfare rates in line with wage growth, which gives a similar increase in income for all population categories in line with growth in national income. Such a budget is also neutral in macro-terms as it maintains the overall share of taxes and welfare expenditure as a percentage of GNP. For our analysis of the distributive impact of Budget 2006 against a neutral budget, a forecast wage growth of 4.8 per cent is used.

## Overview of Budget 2006

Budget 2006 is the fourth budget under the revised National Anti-Poverty Strategy. It is also the fourth budget introduced by the Government. As with its predecessor, the fiscal environment for Budget 2006 was very positive, with exchequer finances boosted by significant growth in tax revenues, while public expenditure was below forecast. The positive state of the public finances enabled a large tax/welfare package of €2,354 million in Budget 2006, 50 per cent higher than Budget 2005 (€1,570 million).<sup>4</sup> Table 1 outlines the main tax and welfare elements of Budget 2006: €958 million (41 per cent) on welfare improvements, €507 million on child income support (21 per cent) and €889 million on income tax changes (38 per cent). Compared to Budget 2005, the biggest increase is on child income support (+€300 million). As a result, its share of the enhanced total package has more than doubled.

Within the social welfare package, the main expenditure item is the rise in personal rates at a cost of €744 million, with a further €64 million for

the qualified adult rates. A sum of €150 million has been allocated to welfare reform measures. The major child support item is the new early childcare supplement (€1,000 per annum) for children under 6 years (cost €353 million in a full year), with the child benefit improvements costing €109 million (full year). On the tax side, the largest item is the widening of the tax band (€456 million), along with the increase in PAYE and personal tax credits (€381 million).<sup>5</sup>

Of particular interest from a distributive viewpoint is the size of the budgetary package in Budget 2006 after indexation of welfare and income tax in line with wage growth. This comes to €1,248 million, two and a half times that available in Budget 2005. The largest share of this (46 per cent) is provided for additional welfare measures, with 29 per cent for child income support (mainly the new childcare payment). Tax represents only a quarter of this amount.

**Table 1:  
Summary of tax/welfare package in Budget 2006 (full year)**

Category	Measures	Cost	Total cost (%)	Cost net of wage indexation <sup>6</sup>
Social welfare	Personal rates	€744m	€958m (41%)	€571m (46%)
	Qualified adult rates	€64m		
	Other	€150m		
Child support	Child benefit	€109m	€507m (21%)	€365m (29%)
	Family income suppl't	€25m		
	Early childcare suppl't	€353m		
	Other	€20m		
Income tax	Tax credits	€381m	€889m (38%)	€312m (25%)
	Rate bands	€456m		
	Other	€52m		
All			€2,354m	€1,248m

<sup>4</sup> These figures are based on full-year costs. This differs from the 2006 cost mainly in regard to child support, as the child benefit increase and the new early childcare supplement both come into effect from April 2006.

<sup>5</sup> The details of the Budget measures, including the financial statement of the Minister for Finance, can be viewed at [www.finance.gov.ie](http://www.finance.gov.ie) and [www.welfare.ie](http://www.welfare.ie).

<sup>6</sup> This is calculated through the SWITCH model and is based on forecast wage growth of 4.8 per cent.

## Distributive impact of Budget 2006

The distribution of the large budget package is now examined by dividing the population into equally sized income groups (deciles and quintiles), ranked from poorest to richest.<sup>7</sup> We begin by looking at weekly gains in disposable income in Budget 2006, which average €10.80 per household unit. All income categories benefit in Budget 2006 because of the significant investment in welfare and tax measures, along with the enhanced child income supports. There is a modest variation between income deciles in the amount being received. The biggest weekly cash gain is for the 2nd to 4th deciles at between €13 and €14.50 per household unit. Similarly, the top 10 per cent of households get higher than the norm, at almost €13 per week. All other deciles get somewhat less than the average, with middle-income deciles (5th to 8th deciles) getting up to €3 per week less.<sup>8</sup>

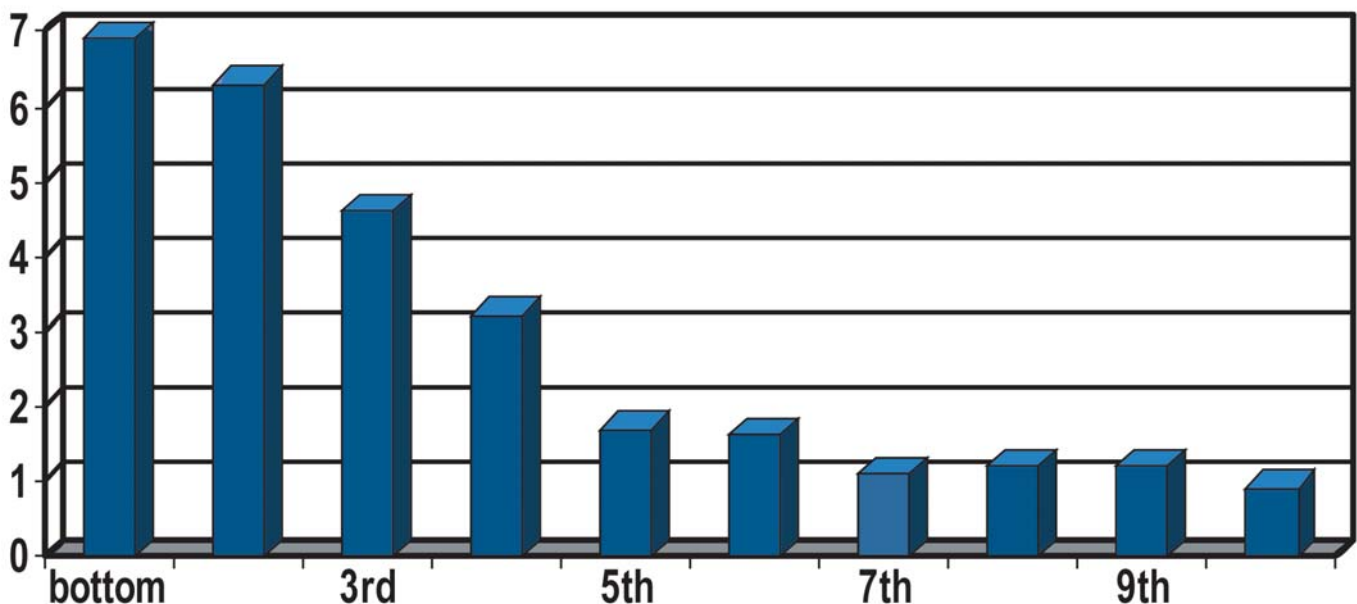
Cash gains can be contextualised by relating them to total household income. Thus, the cash gains from Budget 2006 represent an average improvement of almost 2 per cent in disposable income. (This is on top of wage indexation of 4.8 per cent.) As Diagram

1 shows, there is considerable variation in the benefit across income groups. The greatest boost is for low-income groups, as the bottom two deciles gain 6–7 per cent and the next two deciles get 3–4 per cent. Thereafter, the percentage increase drops dramatically, with all higher income deciles getting less than the average gain. The richest decile gets the smallest increase at less than 1 per cent.

The contrast between the cash and percentage gains in Budget 2006 highlights the underlying inequality of income in Irish society, with the bottom 20 per cent of the population having only one-fifth of the income of the top 20 per cent. Hence, equivalent cash increases are of greater value in proportionate terms to low-income households.

Another perspective on budgetary policy is to examine the share-out of total resources between income categories. In Budget 2006, the bottom four deciles and the top two deciles all receive more than their share, with almost half (47 per cent) going to the former and 22 per cent to the latter. Middle-income groups (5th to 8th deciles) lose out, getting

**Diagram 1:**  
**Distributive impact of Budget 2006 against wage-indexed budget**  
(percentage change in disposable income by decile)<sup>9</sup>



<sup>7</sup> The unit of analysis is an income sharing unit, defined as a single person or married/co-habiting couple plus all children (including third-level students) living with their parents. Disposable income is adjusted for household size using the following equivalence scale: 1 for the first adult, 0.66 for each subsequent adult and 0.33 for each child.

<sup>8</sup> The average weekly adult equivalent amounts received by each decile are as follows: 1st decile – €9.76; 2nd – €14.35; 3rd – €12.92; 4th – €13.76; 5th – €8.76; 6th – €9.28; 7th – €7.20; 8th – €8.71; 9th – €10.65; 10th – €12.69.

<sup>9</sup> The range of disposable income per adult equivalent for each decile is: < €160; €160 – €189; €189 – €228; €228 – €297; €297 – €358; €358 – €411; €411 – €481; €481 – €555; €555 – €698; > €698.

only 32 per cent of the total. The disproportionate amount received by high-income groups highlights the concentrated impact of tax reductions, especially band widening, on high-earning taxpayers.<sup>10</sup> The above-average cash gains for low-income groups reflect the large welfare component in the budget, along with the additional supports for children.

The analysis now moves from income level to household type, based on composition and income source. Table 2 reveals how non-working families do better than their employed counterparts or retired

households in percentage gains. Single and dual unemployed families get an income rise of between 4 and 11 per cent. Retired households fare next best, with gains of around 3 per cent. Generally, employed families do least well. Within this broad and populous category, lone parent and other single earner families gain somewhat more than dual earner families and the single employed. Across all family categories, those with children do better under Budget 2006. This reflects the new early childcare supplement introduced in the budget.

**Table 2:**  
**Distributive impact of Budget 2006, against wage-indexed budget**  
(cash and percentage change in disposable income by family type)

Family type	Cash (€)	Percentage
Single unemployed NC	14.85	10.9
Non-earning lone parents	23.21	7.9
Non-earning couple NC	14.21	4.2
Non-earning couple C	32.40	6.1
Single employed NC	4.91	1.0
Employed lone parent	20.59	4.0
Single earner NC	10.02	1.4
Single earner C	19.53	2.3
Dual earner NC	8.24	0.8
Dual earner C	20.52	1.7
Dual earner other	8.63	1.0
Single retired	7.26	3.1
Retired couple	15.26	2.9
Other	5.88	4.2
All	10.37	1.8

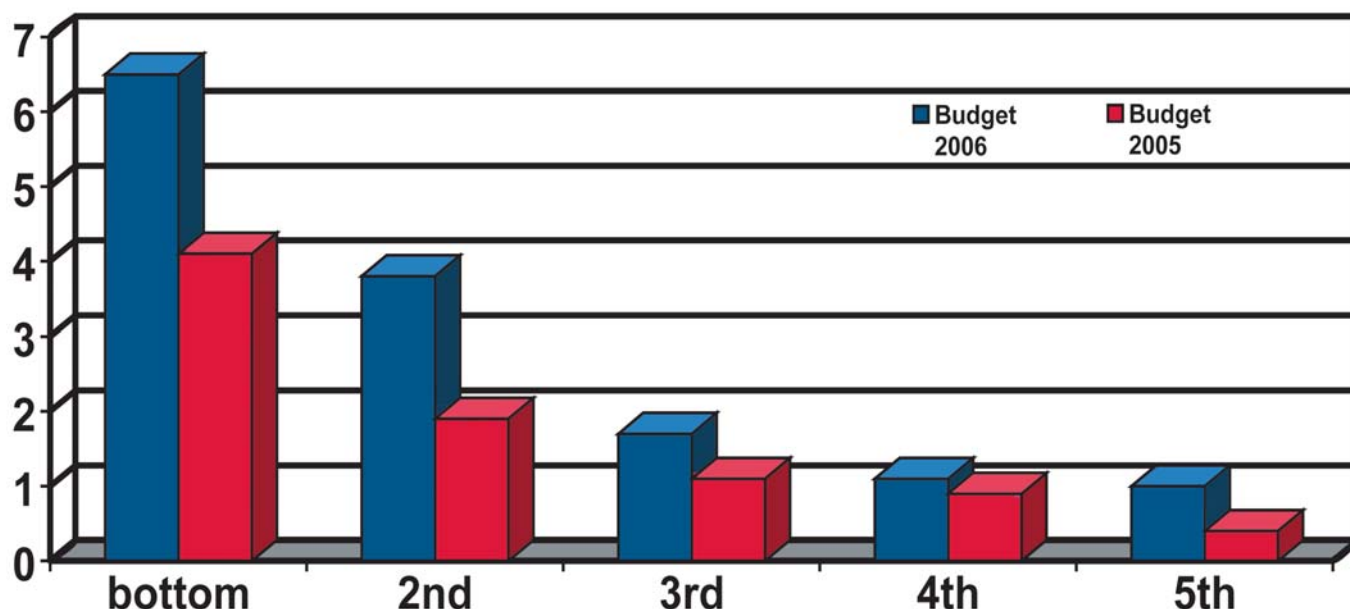
NC – No children, C – Children

<sup>10</sup> The richest 20 per cent of taxpayers pay over 70 per cent of all income tax.

## Budget 2006 in a comparative perspective

Now we examine the distributive impact of Budget 2006 from a comparative perspective. Three levels of comparison are presented here: Budget 2006 is compared with Budget 2005; the underlying pattern is examined over the last four budgets (2003–2006); and, finally, recent budgets are compared with the previous budgetary cycle (1998–2002) to identify policy shifts. These are presented using five equally sized income quintiles, for ease of comparison. Diagram 2 shows that the direction in the last two budgets is similar, though Budget 2006 delivers a far larger gain across all income groups. This reflects the comparative size of the two budgets: Budget 2006 has over twice the scale of Budget 2005, and produces twice the average gain (2 and 1 per cent, respectively). The increased affluence of Budget 2006 for all income groups conceals relatively small variations in the distributional pattern, with the richest quintile doing particularly well. This is accounted for by the larger tax package in Budget 2006, especially the larger band increases compared to 2005.

**Diagram 2:**  
**Distributive impact of Budget 2005 and 2006, against wage-indexed budget**  
(percentage change in disposable income by quintile)



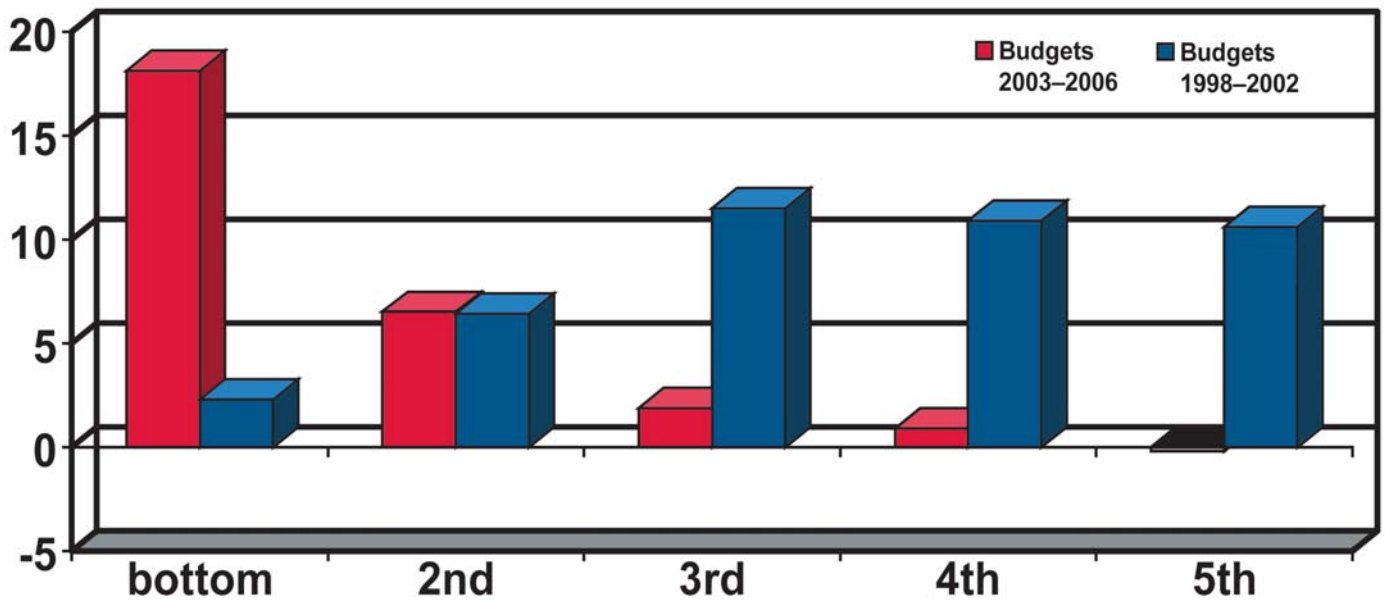
Looking at the four-year pattern of Budgets 2003–2006 (Diagram 3), we see that the overall pattern is redistributive, with gains of up to 18 per cent for the poorest 20 per cent of the population in that time. Two-fifths of this is credited to Budget 2006. The percentage gains taper sharply as we move up the income schedule, with the top 60 per cent of households gaining very little and the richest quintile actually losing. For higher-income groups, Budget 2006 is even more significant, as it accounts for most of the rather minimal improvement over recent years. In summary, Budget 2006 sees the acceleration of the pro-poor trend in tax/welfare policy since 2003 due to the availability of additional government revenues, while also delivering modest

gains for better-off groups after a few years of relative neglect.

Reviewing budgetary policy in a longer-term perspective since 1998, a decisive shift in distributive outcome is apparent. The distribution of the tax/welfare package between the earlier and later periods is quite divergent. In the 1998–2002 era, the gains were concentrated among middle- and higher-income groups (10 and 11 per cent), with those on the lowest incomes recording far less (2 and 6 per cent).<sup>11</sup> Budget policy since 2003 has diametrically reversed this pattern, with the recent priority being on improving the position of low-income households, even to the extent of the richest quintile being

<sup>11</sup> Not all budgets within this period conform to this overall trend. In Budget 2002, the poorest 40 per cent gained up to 4 per cent, as compared to an average increase of 1

**Diagram 3:**  
**Distributive impact of Budgets 2003–2006 and 1998–2002, against wage-indexed budget**  
 (percentage change in disposable income by quintile)



modest losers in the process. However, note that the scale of resources available under budgetary policy in the period 2003–2006 is less than half that allocated in 1998–2002 (€1,580 million as compared to €3,637 million).<sup>12</sup> While Budget 2006 is comparable in scale to budgets in the earlier period, the cumulative amount in Budgets 2003 to 2005 was

far less generous. Thus, the recent shift in tax/welfare policy is despite a smaller level of resources for redistribution than the earlier period. There remains some way to go before the scale of the predominantly tax-oriented budgets at the turn of the millennium is matched by the welfare-focused budgets of recent years.

<sup>12</sup> It should also be borne in mind that we are comparing a five- and a four-year budget cycle and that a complete comparison should be available after Budget 2007.

## The distributive impact of the child income measures

The analysis now looks in more detail at the impact of the large child income package announced in Budget 2006, including the new early childcare supplement. The cumulative value net of wage indexation is a substantial €365 million or 29 per cent of the total available figure. The redistributive impact of the new child welfare policy instrument, with its unique target group (children under 6 years), is of particular policy interest. Also, we assess the Government policy emphasis on child poverty, with the provision of financial support for poorer families central to this. In doing this analysis, we do not factor in actual childcare costs (direct or indirect) faced by families. This is in accordance with the universal focus of the policy.

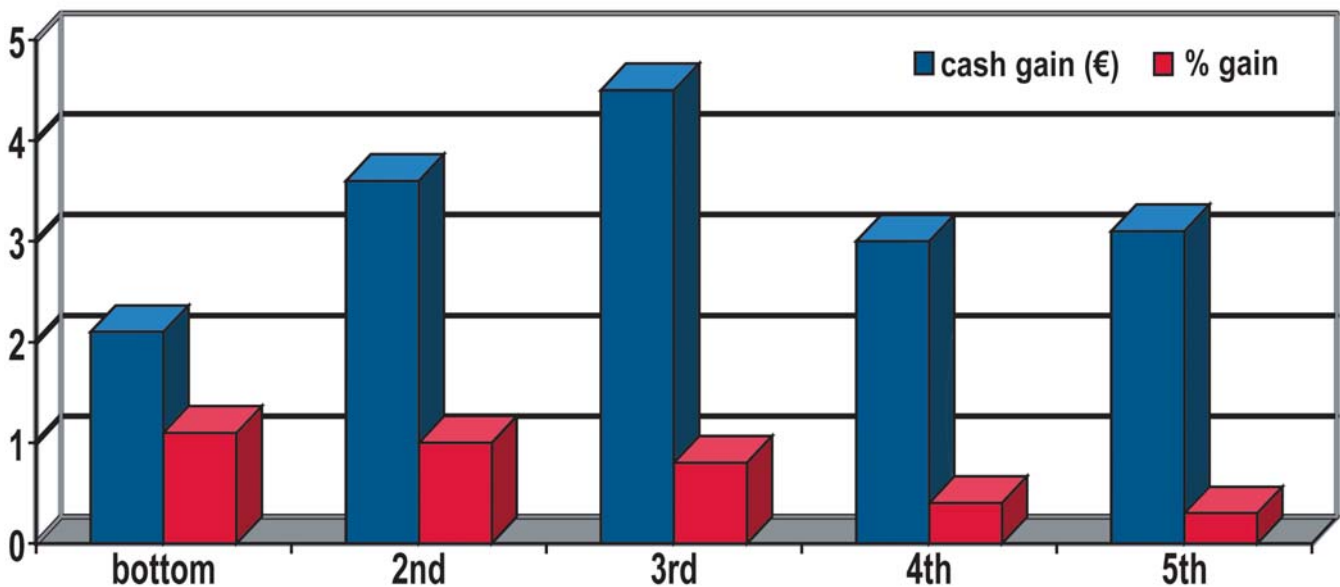
Diagram 4 sets out the cash and percentage gain accruing from the child income measures in Budget

2006. The average cash gain is €3.26 per household unit per week. This gain is concentrated in middle-income households (3rd quintile), who get over €4 per week. The poorest quintile gets the least, at €2 per week. Other income quintiles get the average amount. This variation in benefit is explained by two main factors: first, there are more households with children in the middle-income categories, and therefore they get more benefit from child-specific measures; second, the non-indexation of child dependant allowances represents a cash loss for low-income households. This is especially pertinent in poorer households with older children, especially those aged 19 to 21 years. Hence, we find up to 5 per cent of low-income households record an overall cash loss under the child component of Budget 2006.

**Diagram 4:**

**Distributive impact of child income measures in Budget 2006 against wage-indexed budget**

(cash and percentage change in disposable income by quintile)



This uneven pattern in income gain is still progressive in terms of percentage change (second column in Diagram 4). The distributive effect is frontloaded in favour of low-income households, with gains of 1 per cent for the bottom two quintiles (twice the average). By contrast, better-off households receive less than the average percentage gain. Again, this reflects the fact that cash payments are worth more to poorer households, even with the caveats noted above.

This analysis does not tell the full story, however, as payments are only targeted at households with children, and with younger children in particular. The full impact is apparent when household composition is factored in. The gains are now far more concentrated, with households with children benefiting by between €10 and €18 per week. Differentiating by work status, we find that unemployed one- and two-parent families gain proportionally the most at between 4 and 5.5 per

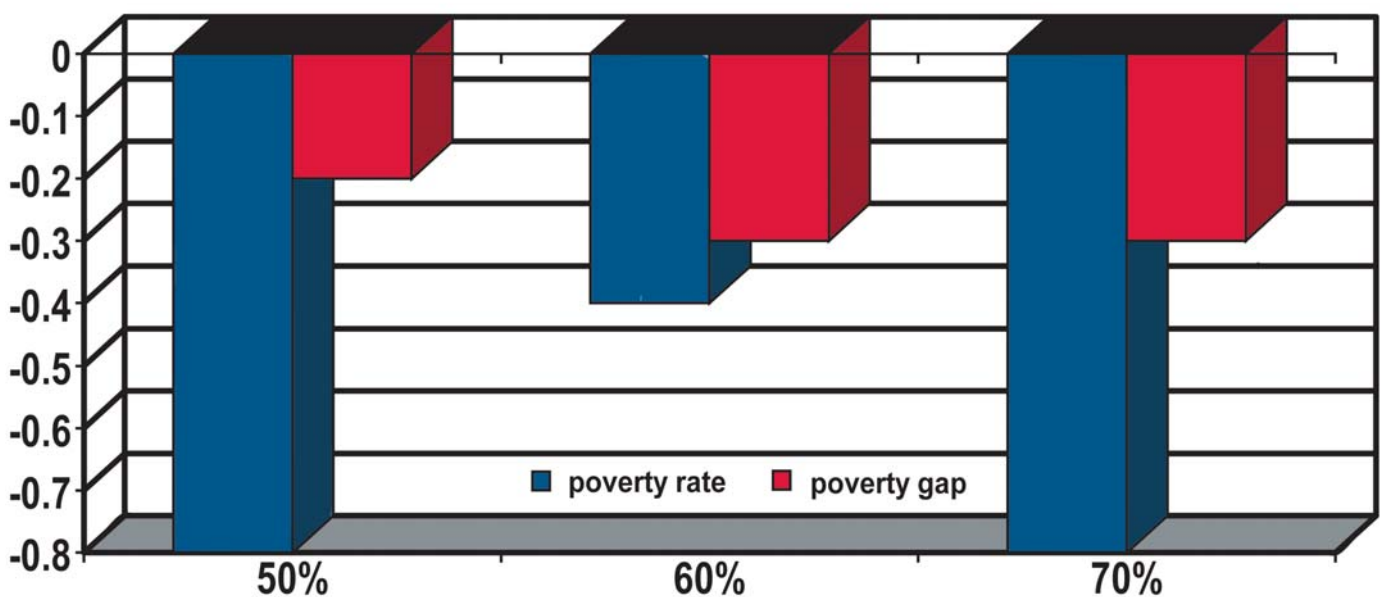
cent. Families with one or two parents working gain 2 per cent or less. (As noted above, this impact does not reflect the actual costs of childcare, which are likely to be higher for working families.)

In overall terms, the child component represents less than one-third of the aggregate percentage change presented in Diagram 1. It clearly adds to the redistributive focus of the budget, though not to the extent of adult welfare increases. The freezing of child dependant allowances is a factor here. Focusing on the early childcare supplement, we find its overall distributive impact is similar to child benefit (as to be expected from a universal payment, albeit within a certain age range). While ostensibly a childcare measure, the new policy has a significant redistributive effect and benefits poorer households more in proportionate terms. However, further investigation is required as to any inequalities between families that may arise as a result of this favouring of younger children.

## Poverty impact of Budget 2006

We turn now to consider the budgetary impact on relative income poverty, again using a wage-indexed benchmark. Diagram 5 illustrates the positive effect of Budget 2006 on various income poverty thresholds.<sup>13</sup> The rate of poverty in the population falls by half a percentage point at the 60 per cent line, and 0.8 per cent at the 50 and 70 per cent thresholds. Another poverty measure is the extent to which the population fall below the various income thresholds (called the poverty gap). This is reduced by between 0.2 and 0.3 of a percentage point under Budget 2006.<sup>14</sup>

**Diagram 5:**  
**Effect on income poverty in Budget 2006 (against wage-indexed budget)**  
 (change in poverty rate and poverty gap at various median income thresholds)



How does Budget 2006 compare to 2005 and what is the cumulative effect since 2002? Last year's budget had a similar impact on income poverty at the 60 per cent line, though a lesser impact at the 50 per cent and especially the 70 per cent thresholds.<sup>15</sup> Diagram 6 illustrates the contrasting poverty impact of budgetary policy over the longer-term. Taken together, the last four budgets have reduced the rate of income poverty by significant amounts: six percentage points at the 50 per cent threshold; three percentage points at the 60 per cent threshold and two percentage points at the 70 per cent threshold.<sup>16</sup>

The poverty gap has also been reduced in this period, by between 1 and 1.5 percentage points.<sup>17</sup> All this contrasts with the previous budgetary period of 1998–2002, when income poverty grew by up to three percentage points.<sup>18</sup>

The scale of these reductions, over a relatively short time period, is significant and highlights the critical role of budgetary policy in reducing relative income poverty in Ireland. While not official policy, it is clear that the Government is pursuing the approach

<sup>13</sup> These changes can also be measured as a proportion of the poverty rate. The fall in the 50 per cent threshold becomes more significant, representing a reduction of almost 10 per cent against a wage-indexed budget. The percentage change in the other thresholds is more modest, at less than 3 per cent.

<sup>14</sup> Again, in proportionate terms, this is the equivalent of a fall of between 5 and 14 per cent, with the biggest impact at the 50 per cent median threshold.

<sup>15</sup> The 2005 figures are: -0.5 percentage point at the 50 per cent line; -0.5 percentage point at the 60 per cent line; -0.2 percentage point at the 70 per cent line.

<sup>16</sup> In relative terms, income poverty has now fallen by over 40 per cent at the lowest level, with lesser percentage reductions at the higher thresholds (14 and 7 per cent, respectively).

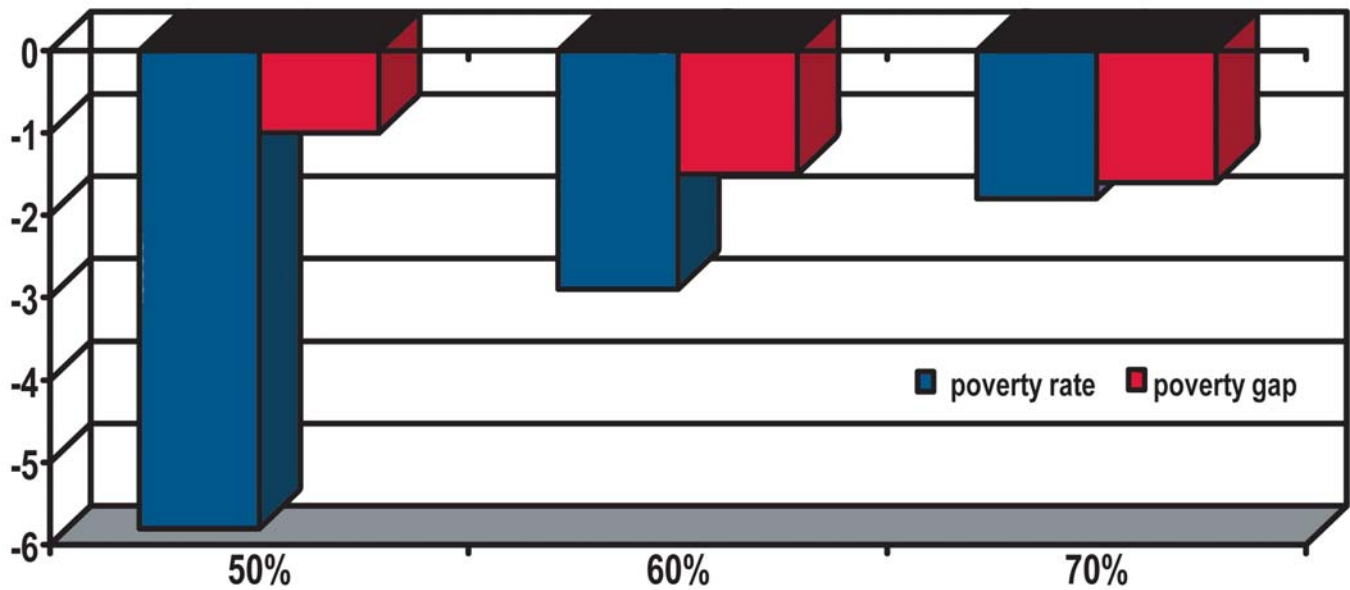
<sup>17</sup> Equivalent to a reduction of 22 to 43 per cent

<sup>18</sup> The data for this period refer to mean income. Poverty increased by 3 per cent at both 40 and 50 per cent of mean income and 1 per cent at the 60 per cent line.

outlined in a 2004 ESRI report on how to reduce poverty rates in line with best European practice.<sup>19</sup> This estimated that an investment of €2,400 million in higher welfare rates (ahead of wage indexation) would be required. Successive budgets since 2003

have delivered over half this figure (€1,300 million). Unlike the proposal in the ESRI report, however, this investment has been funded by budget surpluses rather than higher incomes taxes.

**Diagram 6:**  
**Effect on income poverty in Budgets 2003–6 (against wage-indexed budget)**  
 (change in poverty rate and poverty gap at various median income thresholds)



<sup>19</sup> T. Callan et al. (2004), *Why is relative income poverty so high in Ireland?* Dublin: ESRI

## Policy issues arising from Budget 2006

We now consider specific policy issues pertaining to poverty from Budget 2006. These relate to welfare rates, child income support, welfare reforms, taxation policy, savings and pensions, and social expenditure initiatives.

**Table 3:**  
**Meeting the minimum welfare target<sup>20</sup>**

Year	Welfare rate	Target amount (inflation)	Target amount (wages)
2002	€118.80	€150	€150
2006	€165.80	€167.02	€183.60
2007		€171.20	€191.86
<b>Shortfall</b>		<b>€5.40</b>	<b>€26.06</b>

### Welfare rates

The increase in personal welfare rates in Budget 2006 is between €14 and €17 per week. Continuing last year's approach, the largest increase is in the lower rates (€17 or 10–11 per cent), with the minimum welfare payment now €165.80. By contrast, the higher rates – various pension categories – receive €14 (8 per cent). Over the last four budgets, the basic welfare payment has increased by €47 or 40 per cent, which is almost twice the rate of wage growth and four times the rate of inflation. How does this cumulative increase relate to the Government target of a minimum payment of €150 per week (2002 values) by 2007? Table 3 outlines two uprating mechanisms for the €150 target – price inflation and wage growth – and the consequent increase needed in Budget 2007 to meet the target. Using inflation to uprate, the current gap is less than €2. Factoring in forecast inflation for 2007, the amount required to fully close the gap is a modest €5.40. A wage-adjusted target leaves a larger differential of €18 in 2006. To bridge this in 2007, taking into account likely wage growth, would require a rise of €26.<sup>21</sup> There is some political discretion as to the minimum welfare target for 2007. However, the continued health of the public finances provides ample opportunity to maximise the level of welfare rate increases in next year's budget.

Budget 2006 has a number of special rate increases, including €26.40 on the carer's allowance (17–18 per cent), €6.40 in the allowance for pensioners over

80 years (180 per cent), a €5 increase (55 per cent) in the fuel allowance, and an additional €2 per week for non-contributory old-age pensioners. Qualified adult allowances were increased by between €9.30 and €11.30, which is 66 per cent of the personal rate increase, the standard equivalence scale. No progress was made on the policy target of an adult equivalent scale of 70 per cent (announced in Budget 2000). The target of €200 for the old age pension is within reach for the contributory payment (less than €7), while there is a substantial €18 gap in the means-tested rate.

### Child income support

The extensive child support package in Budget 2006 combines the implementation of existing policy and the introduction of new measures. The child benefit target of €150 per month (€185 for third child), originally set for 2002, is finally met through an €8.40 per month increase (€7.70 for third child) (equivalent to 6 per cent and 4 per cent).<sup>22</sup> Budget 2006 continues the long-standing policy of not increasing child dependent allowances paid to families on welfare. For low-paid families, the earnings thresholds for family income supplement (FIS) are increased in a way that maximises their value for larger families (from €19 to €282 per week, equivalent to 4 and 45 per cent). There is a €40 increase in the clothing and footwear grant (+25 to 50 per cent). The main innovation is the new early childcare supplement, worth €1,000 per annum for all children under 6 years. The purpose of

<sup>20</sup> The inflation rates for the respective years are: 2003 – 3.5 per cent; 2004 – 2.2 per cent; 2005 – 2.5 per cent; 2006 – 2.7 per cent; 2007 – 2.5 per cent. The 2006 and 2007 figures are Dept of Finance forecasts. The cumulative figure for wage increases for 2003–2006 is 22.4 per cent, which is based on the ESRI SWITCH model. The forecast for 2007 is 4.5 per cent.

<sup>21</sup> These calculations take the end of 2002 as the reference point. It could be argued that it should date from the start of 2002, as the target figure was announced in February of that year. Uprating by inflation for that year (4.6 per cent) would give a target figure of €179.07, leaving a shortfall of €13.27 to be made up in Budget 2007.

<sup>22</sup> A consequence of the four-year deferral of the target rate is that its value has been diminished in real terms. Hence, an inflation-adjusted target would be €160, €10 more than the actual figure.

the supplement is to compensate for the higher childcare costs of younger children. In practice, the supplement is a variation of child benefit, a universal payment for all children under 6 years and paid in four quarterly instalments.

Table 4 summarises the expanded structure of child supports. For welfare-dependant families, the child support package is the weekly equivalent of between €53.60 and €72.75 per child. For low-waged families on FIS the standard package is €91.01 per child, rising to €110.16 where the child is under 6 years. All other children in the population receive either €34.50 (standard) or €56.65 (child under 6).

Families with younger children gain significantly from Budget 2006, with combined payments rising by between 40 and 75 per cent. The increase for other children is far more modest, at 21 per cent for FIS recipients and at 5–6 per cent for welfare and other families. Central to this gain for younger children is the early childcare supplement, which represents an important continuity with the existing child benefit. As indicated in Combat Poverty's pre-budget submission, this universalist approach to child support is the preferred policy option. In particular, it models the approach recommended by the Commission on the Family in 1998.<sup>23</sup> However, the absence of any linkage between the new payment and improved access to pre-school education, as envisaged by the Commission, is a disappointment.

Two issues arise from a child poverty perspective. First, the new rates of child support are the equivalent of 32 and 44 per cent of the basic welfare payment, depending on age. The rate for older children is now marginally below the adequacy range set out in the National Anti-Poverty Strategy of 33–35 per cent, while the younger child rate is well in excess of this range. Second, the withdrawal of the early childcare payment, coupled with the higher non-childcare costs of older children, will create financial difficulties for many low-income families. It is disappointing that the Government has not increased the targeted child dependant allowances, either by rationalising the three rates into one higher payment or creating a differential for older children similar to that in the clothing and footwear allowance. This issue is likely to get further consideration in the context of the forthcoming National Economic and Social Council report on the merger of child dependent allowances and FIS.

### Welfare reforms

The welfare package in Budget 2006 introduced reforms in the structure of the welfare system. These reforms focus on eligibility criteria and assessment of earnings as they relate to various welfare schemes.

- A uniform non-contributory state pension is replacing six different schemes, with an improved means test. Included here is a new earnings disregard of €100, as an incentive for older people to continue in employment. The latter is an

**Table 4:**  
**The structure of child income support post-Budget 2006<sup>24</sup>**  
(standard rates in weekly € equivalents)

Category	CDA	FIS	CFA	CB	ECS	Total	Increase
> 6 years	16.80	–	2.30	34.50	19.15	<b>72.75</b>	<b>43%</b>
< 6 years	16.80	–	2.30	34.50	–	<b>53.60</b>	<b>5%</b>
Low paid							
< 6 years	–	54.21	2.30	34.50	19.15	<b>110.16</b>	<b>47%</b>
> 6 years	–	54.21	2.30	34.50	–	<b>91.15</b>	<b>47%</b>
Other							
< 6 years	–	–	–	34.50	19.15	<b>53.65</b>	<b>74%</b>
> 6 years	–	–	–	34.50	–	<b>34.50</b>	<b>6%</b>

<sup>24</sup> The Commission proposed a £1,000 (€1,270) per annum early years opportunities subsidy for all children from three years to commencement of primary school. The subsidy would be centred on the child and directly related to the purchase of early childhood education services. See Commission on the Family (1998), *Strengthening Families for Life*, Dublin: Department for Social, Community and Family Affairs

<sup>23</sup> CDA = child dependant allowance (basic rate is €16.80 per week; higher rates are €19.30 and €21.60); FIS = family income supplement (average payment per child is €54.21 per week); CFA = clothing and footwear allowance (standard rate is €120 per annum [2–11 years], rate for 12–22 years is €190 per annum or €3.64 per week); CB = child benefit (standard rate is €150 per month; rate for third plus child is €185 per month or €42.50 per week); ECS = early childcare supplement (rate for all children under 6 is €250 every quarter).

important measure in terms of boosting the incomes of older people on means-tested pensions.

- The earnings threshold for the One Parent Family Payment (OPFP) is increased by €80 (28 per cent), to enable working lone parents to earn more while continuing to be in receipt of a reduced payment. Other reforms in the structure of the OPFP are likely to follow publication of a Departmental review.
- Changes are being introduced in the supports for family carers. This includes greatly enhanced payments (highlighted above), a more generous means test, and extended duration of benefit.
- Additional resources are provided to tackle fuel poverty, including higher fuel allowance and increased investment in the warm homes programme – a home insulation initiative of Sustainable Energy Ireland.
- New welfare-to-work initiatives for people with a disability, recipients of rent and mortgage supplements, the long-term unemployed, and working spouses/partners of welfare recipients are introduced.

### **Taxation policy**

The income tax changes in Budget 2006 sought to benefit workers on the minimum wage through increases in the employee and personal tax credits (€220 and €50, respectively, or 17 and 3 per cent). These changes, while of benefit to all taxpayers, confer the greatest percentage gain to the low paid. As a result, one-third of the workforce will be tax-exempt. However, for those whose earnings fall well short of the tax threshold, these changes will have no benefit. The other major income tax change is in the standard rate band, which increase by €2,600 (9 per cent). Widening the tax band is a regressive measure, as it only benefits higher earners. However, it is still a fairer policy option than reducing the higher rate of tax.

In terms of tax reform, Budget 2006 featured a number of actions arising from the review of property and other incentive tax reliefs. The review highlighted two key tax issues: the high cost of the reliefs vis-à-vis the economic and social returns and

the extensive use of the reliefs by high earners to minimise their tax liabilities. Subsequently published reviews indicate that tax savings of approximately €3,000 million have been made in recent years mainly by high earners through the various tax reliefs, and that a further €1,000 million is due to be made over the coming years.<sup>25</sup> In response, the Government announced the termination of certain reliefs, subject to transitional arrangements. For continuing reliefs, better reporting and assessment of their impact is required. In addition, an annual cap on the value of specific reliefs to individual taxpayers is being introduced. This measure will increase the effective tax rate for high earners towards a minimum of 20 per cent. A third reform is to cap the maximum total earnings for tax relief on pensions. These reforms are welcome and should maximise tax revenues in the years to come and make the tax system fairer, especially where very high earners are concerned.

There remain other aspects of the tax system which warrant urgent review from a social equity perspective, in particular the distributive effect of indirect taxes. All income groups pay indirect taxes, which now account for half of the tax take and 50 per cent more than income tax returns. Furthermore, their effect is far more regressive than other forms of taxation, accounting for one-fifth of the incomes of the poorest decile compared to 10 per cent of the richest.<sup>26</sup> In this context, the avoidance of higher VAT rates in Budget 2006 is welcome. However, a rebalancing of the tax burden from regressive to progressive taxes is required.

### **Savings and pensions**

Savings and pensions policy has emerged as a key issue in recent years, in the face of the medium- to long-term ageing of the population and the increasing poverty risk for older people dependant on a welfare pension. There are significant exchequer incentives for private pensions, amounting to almost €3,000 million per annum. A related savings initiative, the Special Savings Incentive Account (SSIA) scheme, is estimated to cost the exchequer a total of €3,000 million before maturity in 2007. Further measures are proposed in the Finance Bill 2006, including an incentive to convert SSIA's into pension savings for those on low-incomes. The policy priority identified in the National Pensions

<sup>25</sup> The three reviews are available on the Department of Finance website: [www.finance.gov.ie](http://www.finance.gov.ie).

<sup>26</sup> See forthcoming Combat Poverty study on this issue: A. Barrett and C. Wall (2006) *The distributive impact of Ireland's indirect tax system*, Dublin: Combat Poverty Agency.

Review is the low up-take of occupational pensions,<sup>27</sup> which is concentrated among lower earners in the private sector.<sup>28</sup> A more radical approach is now required to increase pension coverage. Central to this should be a universal pension scheme, prioritising those currently without a pension. Second, the current substantial tax expenditures on pensions should be reprioritised in line with a targeted approach to those with inadequate pension coverage. Third, the value of the basic state pension should be increased, in line with a new long-term policy target. Fourth, a savings scheme for low-income households should be developed, which would provide a short-term buffer for fluctuating incomes, and act as a prelude to a long-term savings mechanism for retirement.<sup>29</sup>

### **Social expenditure initiatives**

Budget 2006 contained two social expenditure initiatives: home/community care of older people and childcare. Meeting the long-term care needs of older

people is a critical factor in determining the quality of life for older people, especially as people are living longer. Access to affordable childcare enables families to take up employment. It is also a mechanism for the provision of developmental opportunities for children at risk of educational disadvantage. The budget provides start-up funding for a new five-year €575 million National Childcare Investment Programme, to succeed the Equal Opportunities Childcare Programme. Its aim is to create an extra 50,000 childcare places. Related measures are longer maternity leave, tax exemption of small childcare providers, and the early childcare supplement (discussed above). The administrative arrangements for childcare are also being changed, with the new Office of the Minister for Children assuming responsibility for all aspects of childcare. While these general reforms are welcome, the absence of a commitment to increase provision of pre-school education is disappointing from a child poverty viewpoint.

<sup>27</sup> See Combat Poverty Agency submission to the National Pensions Review (2005).

<sup>28</sup> Pensions Board, *National Pensions Review*, Dublin: (2005).

<sup>29</sup> Combat Poverty, in conjunction with the Money Advice and Budgeting Service, has developed a proposal for a targeted savings initiative as part of a 'rehabilitation' programme for indebted households.

## Conclusion

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Tax/welfare policy has a key role to play in redistributing resources and reducing relative income poverty, under the framework of the National Anti-Poverty Strategy. Budget 2006 significantly enhances the progressive out-turn of recent budgets, delivering gains of up to four times the average for low-income groups, though higher earners gain equivalent amounts in cash terms. Budget 2006 has a positive effect on relative income poverty, especially at the lowest threshold. The engine of redistribution is the big increases in welfare rates, though the significant allocation on child support contributes to the overall pattern. The tax package, while costly in terms of government resources, delivers proportionately less to better-off groups than the welfare measures. Overall, the Government is

well on its way to reducing income poverty in line with European best practice, a significant achievement in the context of the EU social inclusion strategy and a welcome boost for the forthcoming National Action Plan on poverty 2006–2008. The closure of loopholes in the tax system will provide additional resources going forward, mainly at the expense of very well-off taxpayers. These potential tax revenues, together with ongoing buoyancy in the exchequer finances, provide the resources for 'pain-free' redistributive tax/welfare policies in the years ahead. More broadly, targeted policy initiatives on pensions, care of older people, and early childhood education remain expenditure priorities in building an inclusive society.



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