

Analysis of Budget 2008

 **Combat Poverty
Agency** *working for a
poverty-free Ireland*

Key points

- The money available for tax and welfare changes in Budget 2008 was €1,620 million. This was down over €1,000 million (41%) on Budget 2007.
- Compared to Budget 2007 spending on social welfare was down €410 million; spending on income tax was down €670 million; and spending on child income support was down €50 million.
- The spending pattern in Budget 2008 was different to Budget 2007. The proportion of the budget spent on welfare went up from 42% to 46%. The spend on child welfare support went up from 9% to 12%. By contrast, the spend on income tax was down from 49% to 42%.
- The average percentage gain across all income categories from Budget 2008 was 0.1% (or €1 per household unit per week).
- The bottom 20% of income groups gained between 1 and 1.5% from Budget 2008 (compared to an average gain across all income groups of 0.1%).
- The fall in income poverty for people at or below 50% of median income (€229 per week in cash terms) was 11.5%. There was little change at the 60% and 70% thresholds.
- The reductions in income poverty were concentrated among older people (particularly older women). There was little change in the levels of child poverty.



1. Introduction

This analysis assesses the impact of the tax/welfare measures introduced in Budget 2008 on poverty and on inequalities relating to poverty. The analysis is in keeping with the requirement for a poverty impact assessment of all major policy proposals under the National Anti-Poverty Strategy and the National Action Plan for Social Inclusion. It complements the assessments of aspects of Budget policy undertaken by individual government departments.¹

This analysis is undertaken as part of the statutory remit of Combat Poverty to provide evidenced-based advice on public policy relating to poverty. Central to

this exercise is the use of the ESRI micro-simulation model (SWITCH) to examine the effect of welfare and tax changes for a national representative sample of households². The analysis uses objective indicators to quantify distributive and poverty impact, which are widely used at EU levels. This gives a unique perspective on the overall impact of the Budget as compared to headline changes in welfare rates or tax credits or case studies of tax/welfare changes for sample households. The analysis also compares the Budget outcome with previous budgets and with the pre-Budget submission made by Combat Poverty.

- 1 A partial 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
- 2 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.

2. Budget 2008: an overview

The fiscal context for Budget 2008 was less positive than in previous years, with a significant shortfall in forecast tax revenues in 2007 and a larger borrowing requirement than expected. The deterioration in the public finances resulted in a reduced tax/welfare package of €1,620 million in Budget 2008.³

Table 1 outlines the main elements of the tax/welfare package. Welfare improvements account for the largest allocation at €752 million (46 percent of the total), with €672 million provided for reductions in income tax (42 percent of the total). A further €194 million (12 percent) is spent on child income support.

The tax/welfare package in Budget 2008 is down

€1000 million on Budget 2007 (-41 percent). There are significant reductions across all the main allocations, though not of an equivalent percentage. Thus, social welfare is down €410 million (-35 percent), income tax reduced by €670 million (-50 percent) and child income support cut by €50 million (-20 percent). As a result of these variable cuts, the composition of the Budget is changed from the previous year, with the social welfare share up from 42 to 46 percent and child income support now 12 percent, up from 9 percent. By contrast, the allocation on income tax is down 7 points from 49 to 42 percent. This outcome shows a greater priority being given to welfare support at a time of reduced resources.

Table 1: Tax/welfare expenditure in Budgets 2008 and 2007

	Budget 2008 €m (%)	Budget 2007 €m (%)	Change €m (%)
Social welfare	752 (46%)	1,162 (42%)	- 410 (-35%)
Child income support	194 (12%)	244 (9%)	- 50 (-20%)
Income tax	672 (42%)	1,342 (49%)	-670 (-50%)
Total	1,618 (100%)	2,748 (100%)	-1,130 (-41%)

Table 2 summarises the main features of the tax/welfare package. On the welfare side, the main item is the increase in personal rates of between €12 and €14 per week, totalling €636 million or 85 percent of the welfare spend. The qualified adult rate generally increases by between €7.90 and €9.70 per week, depending on welfare category. The qualified adult rate (over 66 years) for the contributory state pension gets a special increase of €27 per week. The cost of the improvements in the qualified adult rates is almost €90 million. Budget 2008 provided for changes in the administration of various schemes, including an extension of the duration of the fuel allowance by 1 week (to 30 weeks). These changes cost in the region of €26 million.

The child income package of €194 million is spread across five schemes. The main cost item is the increase in child benefit of €6 - €8 per month, at €90 million or almost half of the total. The other universal child payment, the early childcare supplement goes

up by €25 per quarter (cost €46 million). Child dependant allowances, payable only to welfare recipients, increase by €2 per week to €24, at a cost of €32 million. The weekly income thresholds for Family Income Supplement (FIS), targeted at low-paid families, increase by €10 per child per week. This item costs €17 million. There is a €20 increase in the clothing and footwear allowance, an annual payment to low-income families. Other child related expenditure include school meals (€2m) and the widowed parent grant (€2.6 million).

On the income tax side, employee and personal tax credits both rise by €70 per annum, at a combined cost of €244 million. The standard rate tax bands are widened by €1,400 per annum for a single person and for a one-income married couple (€266 million). Other adjustments in income tax allowances and thresholds for PRSI and the health levy cost €72 million. There are also targeted measures relating to mortgage interest relief and tax reliefs, at a cost of €90 million.⁴

³ These figures are based on full year costs.

⁴ The details of the Budget measures, including the financial statement of the Minister for Finance, can be got at www.finance.gov.ie and www.welfare.ie.

Table 2: Main features of tax/welfare package in Budget 2008

Social Welfare	Measures	Cost (€m)
Personal rates		
- contributory state pension*	+ €14 per week	206.3
- carers allowance/benefit	+ €14 per week	25.2
- other welfare categories	+ €12 per week	404.7
Qualified adult rates		
- contributory state pension	+ €27 per week	53.5
- other welfare categories	+ €7.90 to €9.30 per week	35.1
Fuel allowance	Duration extended by 1 week	5.4
Maternity & Adoptive	+ €14 per week on min rate	2.0
OPFP	Thresholds increased by €25 per week	1.4
Benefit and Privilege	Introduce a single reformed method	2.5
Cost of Education Allowance	+ €100 per annum	0.8
Carers	Respite care grant increased by €200 and improvements in disregards etc	12.5
Other		2.6
Total		752

Child income support	Measures	Cost (€m)
Early Childcare Supplement	+ €25 per quarter	46.0
Child benefit	+ €6/€8 per month	90.3
Child dependent allowances	+ €2 per week	32.1
Family income supplement	threshold increased by €10 per child	17.3
Clothing/footwear allowance	+ €20 per annum	3.8
School meals scheme	Funding increase of €2 million	2.0
Widowed Parent Grant	+ €2,000	2.4
Total		194

Income tax	Measures	Cost (€m)
Employee tax credit	+ €70 per annum	} 244
Personal tax credit	+ €70 per annum	
Home carer tax credit	+ €130 per annum	12
Standard rate bands	+ €1,400 per annum	266
Other personal tax charges		24
PRSI threshold	+ €13 per week	13
Health levy threshold	+ €20 per week	23
Mortgage interest relief	+ €2,000 per annum in interest ceiling	20
Discretionary tax reliefs		70
Total		672

* Including all contributory schemes for persons aged 66 and over e.g. Widow/er's Contributory Pension.

3. Distributive impact of Budget 2008

We now examine the distribution of the tax/welfare resources across the population using the SWITCH model. A key component in the analysis is the comparator budget. The standard approach is to examine budget changes against a backdrop of no policy change, ie 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 for those depending on welfare payments, as inflation erodes the real value of fixed nominal payments. At the same time income growth with fixed credits and bands means that taxes rise as a proportion of income ('fiscal drag').

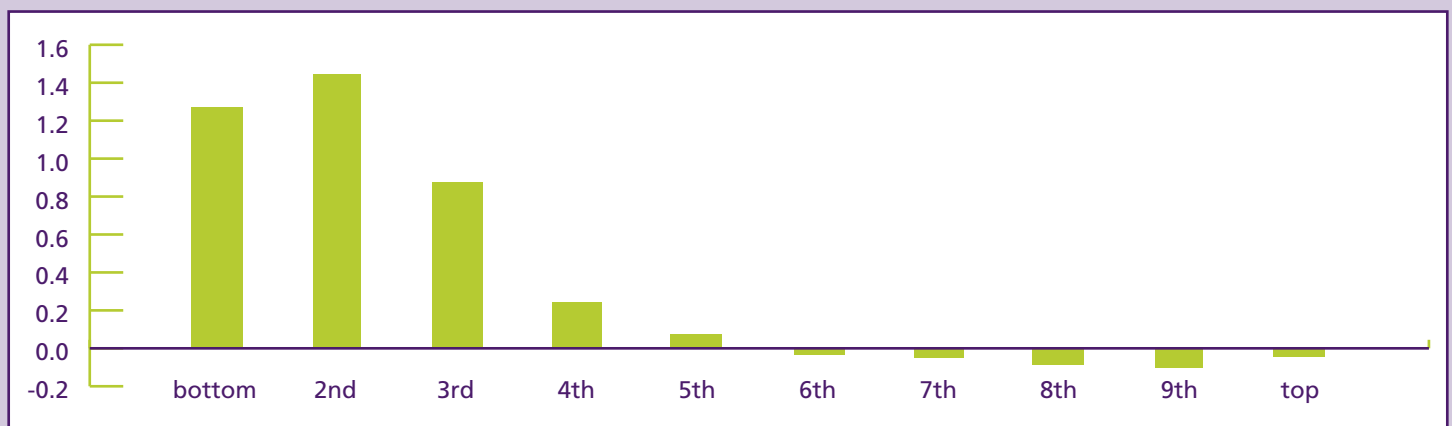
An alternative benchmark is to index tax and welfare rates in line with wage growth, which gives a similar increase in income for all population categories in line with growth in national income. Such a budget is both distributionally-neutral and maintains the overall share of taxes and welfare expenditure as a percentage of GNP. For this analysis of Budget 2008,⁵ the 2007 tax and welfare rates are increased by 4.5 percent, the wage growth forecast for 2008.

The distributive analysis focuses on the first-round impact of budgetary changes, based on the technical assumption of no change in behaviour.

In Budget 2008, the resources available after indexation of welfare and income tax in line with wage growth amount to a modest €110 million. The distribution of this amount is presented in diagram 1, based on a ranking of the population in ten equally sized income deciles from poorest to richest.⁶

The average percentage gain from Budget 2008 is 0.1 percent (or €1 per household unit per week). However, there is considerable variation in the percentage gain across income deciles. The bottom three deciles gain between 1 and 1.5 percent, the equivalent of between €2.50 and €4 per week. There is a sharp decline in the gain from the 4th decile up. Indeed, income categories in the top half of the income distribution record a slight loss compared to a wage-indexed Budget.

Diagram 1: Distributive impact of Budget 2008 against a wage-indexed 2007 policy
(percentage change in disposable income by decile)⁷



⁵ ESRI *Quarterly Economic Forecast*, December 2007. This benchmark is an important difference as compared to the approach adopted by the Department of Finance in its use of SWITCH to assess the poverty impact of the Budget, which uses an unchanged 2007 policy.

⁶ 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.

⁷ The range of disposable income per adult equivalent for each decile is: 1st ≤€198.22; 2nd >€198.22 ≤€229.2; 3rd >€229.2 ≤€279.43; 4th >€279.43 ≤€354.56; 5th >€354.56 ≤€437.16; 6th >€437.16 ≤€512.53; 7th >€512.53 ≤€594.15; 8th >€594.15 ≤€693.46; 9th >€693.46 ≤€862.89; 10th >€862.89

4. Poverty impact of Budget 2008

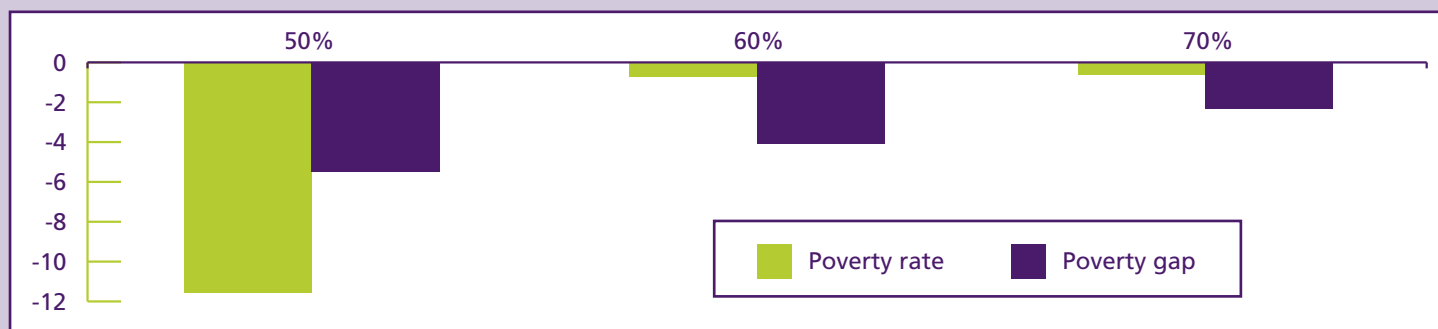
We turn now to consider the budgetary impact on relative income poverty, again using as the comparator a wage-indexed 2007 policy. This impact is measured using the percentage of the population below income poverty or 'risk-of-poverty' thresholds, set at 50, 60 and 70 percent of median income⁸.

Use of a number of thresholds also helps to distinguish the severity of income poverty and gives a more balanced picture where cut-off points are highly sensitive to changes in the rate of social welfare.⁹ These thresholds are effectively unchanged as compared with a wage-indexed 2007 policy, which is in keeping with the marginal change in average income outlined previously. In addition to the poverty

rate (or headcount), we measure the extent to which households fall below these income thresholds - referred to as the poverty gap - to see if they are moving closer to or further from the cut-off points.

Diagram 2 shows that the impact on income poverty is concentrated at the lowest 50 percent threshold, with a drop of 11.5 percent. There is minimal change (less than 1 percent) at the 60 percent and 70 percent thresholds. There is evidence of a more consistent impact on the poverty gap, with a reduction of between 2 and 5.5 percent across the three thresholds. As with the headcount measure, the biggest impact is at the lowest threshold.

Diagram 2: Effect on income poverty rate and gap in Budget 2008 against wage indexed 2007 policy
(percentage change at 50%, 60% and 70% of median income)



It is important to look at the impact on poverty for vulnerable groups such as older people, children and women¹⁰. Diagram 3 shows that the poverty impact of Budget 2008 is concentrated among older people, with a fall of over 50 percent in the numbers below the lowest income threshold. The reduction for women is 11 percent and for children 3 percent. The reductions at the other thresholds are marginal, with the greatest impact again for older people. At the 60 percent threshold, the fall in income poverty for older people is 1.6 percent, though the differential with women (0.7 percent) and children (0.2 percent) is much reduced. The reduction for all groups at the 70 percent is similar at less than 1 percent. This pro-

elderly pattern is replicated in terms of the poverty gap, though children and women do somewhat better than in the headcount measure.

We can also report on the poverty impact for one group which was the target of particular attention in Budget 2008: older women. The poverty rate for this group fell by 61 percent at the lowest threshold, compared to a reduction of 44 percent for older males. The change in poverty rate at the higher thresholds is marginal, in keeping with the overall trend. This fall shows the potential of targeted welfare increases to effect significant change in the poverty rate for specific social groups.

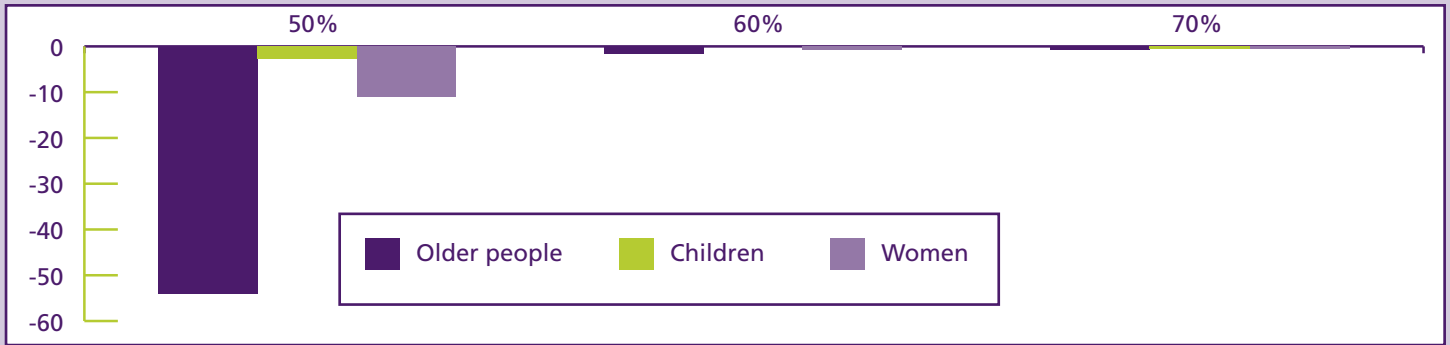
⁸ These are the official indicators used by the European Commission to compare poverty levels in the EU. It is not possible to measure the effect on consistent poverty, the Irish government measure. However, income poverty is one component of the consistent poverty indicator.

⁹ The weekly equivalised disposable income at these thresholds post Budget 2008 is: 50 percent = €229; 60 percent = €275; 70 percent = €321.

¹⁰ It is not possible at this stage to look at other social categories such as people with disabilities or non-nationals.

Diagram 3: Effect on income poverty rate for older people, children and women in Budget 2008, against wage indexed 2007 policy

(percentage change at 50%, 60% and 70% of median income)



5. Budget 2008 in a comparative perspective

Now we examine the impact of Budget 2008 from a comparative perspective to identify policy trends over time. Budget 2008 is compared with its predecessor, Budget 2007, using five equally sized income groups (quintiles) for ease of analysis (Diagram 4). The first point to note is that the average gain in Budget 2007 is 1.5 percent, compared to 0.1 percent in Budget 2008 (the net resources over indexation in the two Budgets were €1,000 million and €110 million

respectively). Second, the redistributive focus in the two Budgets is broadly similar. Budget 2007 increases lower incomes by between twice and three times the average. Budget 2008, though delivering a significantly smaller benefit, is even more targeted at lower income groups. Third, the average 1 percent gain received by better-off households in Budget 2007 more than compensates for the slight loss experienced by these groups in Budget 2008.

Diagram 4: Distributive impact of Budget 2007 and 2008, against wage indexed policies
(percentage change in disposable income by quintile)

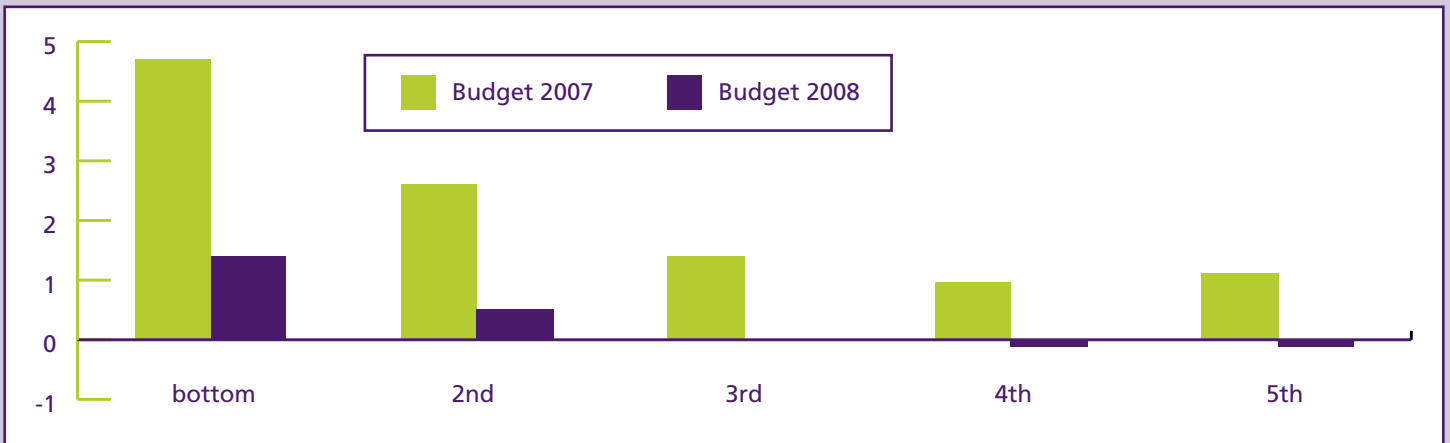
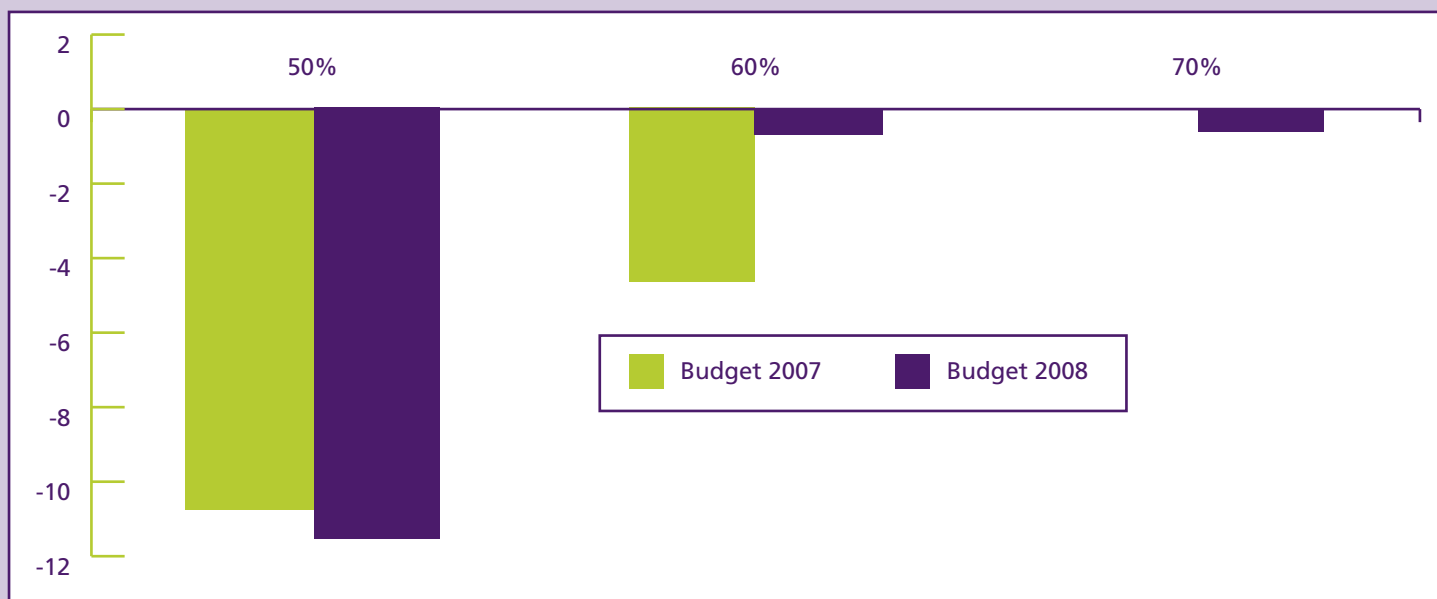


Diagram 5 compares the poverty effect of Budgets 2007 and 2008 (focusing on the poverty rate only). At the lowest threshold, the reduction in income poverty is identical under both Budgets. This may appear surprising at first given the smaller percentage gain for low-income groups in Budget 2008. However, the targeted nature of Budget resources, combined with an unchanged median income, maximises the

reduction in the severest level of poverty. By contrast, there is a variation in the fall in numbers below the 60 percent threshold across the two Budgets. The reduction in the poverty rate at this threshold is six times greater in Budget 2007 as compared to 2008. At the highest threshold (70%), neither Budget makes an impact on the poverty rate, though Budget 2008 has a marginally better effect.

Diagram 5: Effect on income poverty in Budgets 2007 and 2008 against wage-indexed policies
(percentage change at 50%, 60% and 70% of median income)



6. Combat Poverty proposals

How does Budget 2008 compare with the proposals made by Combat Poverty in advance of the Budget?¹⁰ In its pre-budget submission, (PBS) Combat Poverty proposed a budget costing €2,700 million, in line with Budget 2007. The actual tax/welfare expenditure in Budget 2008 was significantly less at €1,620 million. While the scale of resources is different between the two Budgets, the structure of the Budgets has more in common, especially on the welfare side. In the Combat Poverty (PBS), half of the resources is allocated to welfare improvements, which is similar to the Budget outturn of 46 percent. A quarter of the Combat Poverty PBS is provided for child income support, while the allocation in Budget 2008 is half that at 12 percent. The biggest structural difference is in regard to income tax measures, which represented 24 percent of the PBS, as compared to 42 percent in Budget 2008.

Looking at specific measures, the main difference in the welfare changes is in regard to the increase in rates. Combat Poverty had proposed a flat €20 increase across the board, while Budget 2008 provided for a two-tier increase of €12 and €14.

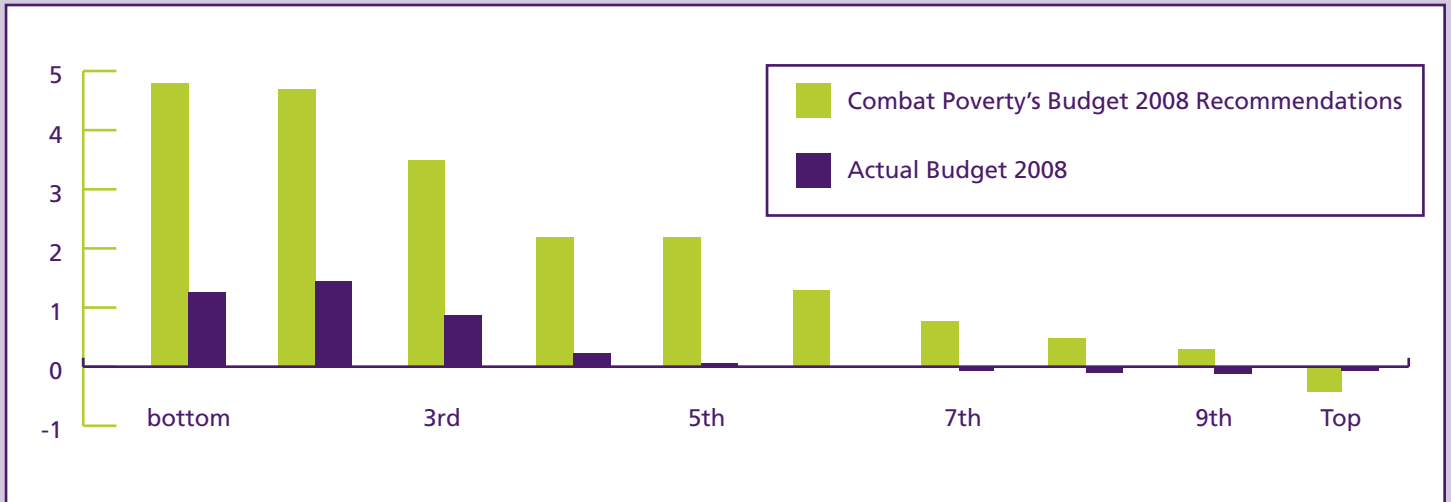
The approach to child income support is similar in both Budgets – improvements in universal and targeted schemes – with Combat Poverty proposing higher rate increases than actually delivered. On the

income tax side, there is common ground in regard to the changes in income tax credits and bands. The one issue where the two Budgets diverge is in regard to reform of PRSI. Combat Poverty set out proposals for a cost-neutral restructuring of PRSI, abolishing the ceiling and increasing the credit. Budget 2008 did not address this issue, despite a commitment to PRSI reform in the Programme for Government.

The larger welfare/tax package in the Combat Poverty PBS is reflected in the average gain of 1.1 percent, which is ten times that delivered in Budget 2008. Diagram 6 compares the distributive outcome of Budget 2008 with that achieved in the Combat Poverty package. The direction of both Budgets is focused on lower-income groups, in particular the bottom 30 percent of the population. However, the Combat Poverty PBS delivers five times the percentage gains as Budget 2008 for these groups. There is a greater contrast in the position of the fourth and fifth deciles. Under Budget 2008, the gain for these income groups is in line with the average gain. By contrast, Combat Poverty's PBS targets additional resources at these groups. There is again common ground in the treatment of the top half of the income distribution. In both proposals, these gain less than the average. However, only the richest decile records a loss under Combat Poverty proposals, while all of the top deciles lose slightly under Budget 2008.

¹⁰ See Combat Poverty (2007), *Mainstreaming poverty and social exclusion. Proposals for Budget 2008*. Dublin: Combat Poverty

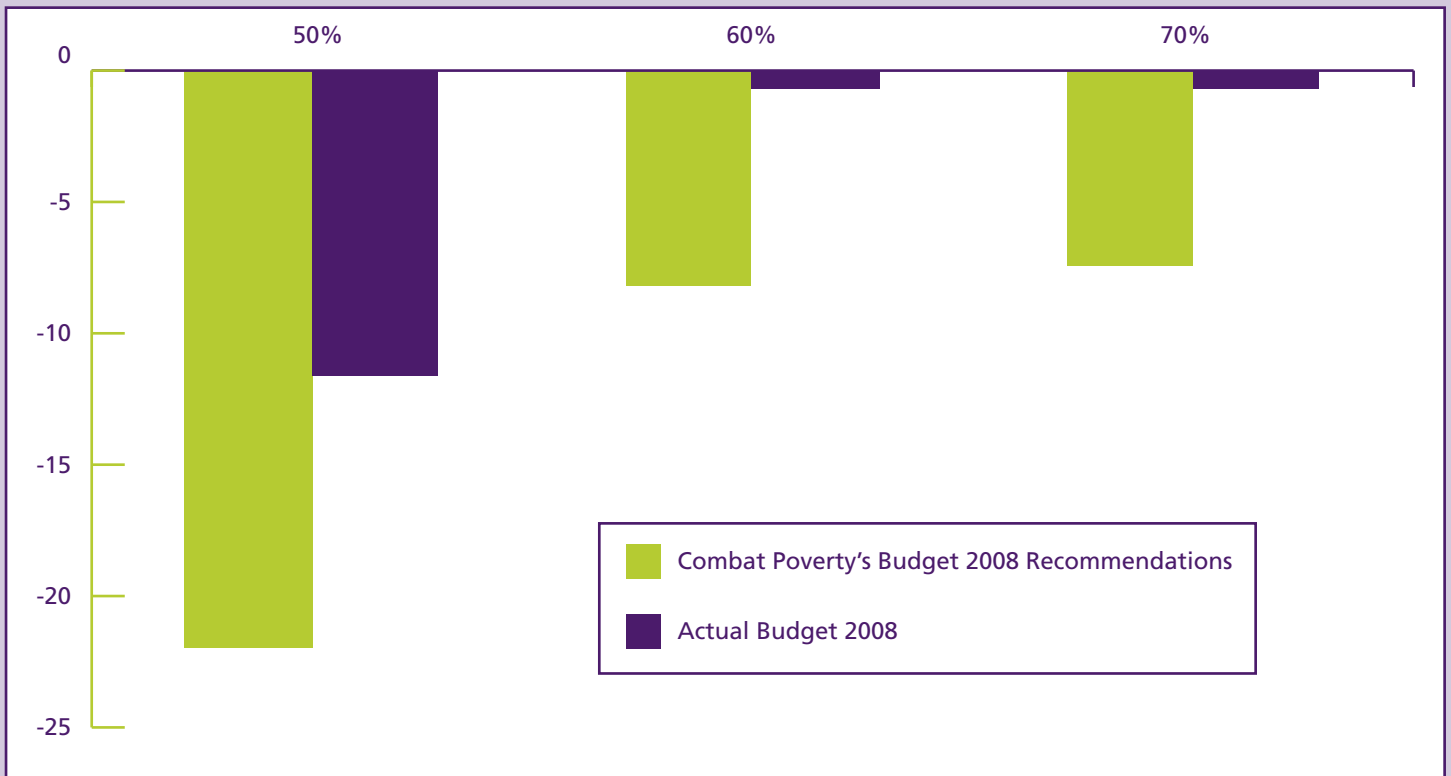
Diagram 6: Distributive impact of Combat Poverty PBS and Budget 2008
(percentage change in disposable income by decile)



The impact on poverty of the Combat Poverty proposals and Budget 2008 is illustrated in diagram 7. The greatest reduction in poverty is recorded at the lowest income threshold in both Budgets, through the fall under the Combat Poverty Agency PBS is twice

that achieved in Budget 2008. Further reductions in poverty are apparent under the Combat Poverty Budget at the 60 and 70 percent thresholds. By contrast, Budget 2008 has minimal impact at these cut-offs.

Diagram 7: Effect on income poverty in Combat Poverty PBS and Budget 2008
(change in poverty rate at 50%, 60% and 70% median income thresholds)



7. Conclusion

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 and its successor, the National Action Plan for Social Inclusion.

In a tight fiscal context, Budget 2008 retains the progressive outturn of recent budgets, delivering modest gains of 1 to 1.5 percent for low-income groups. Budget 2008 also has a positive effect on relative income poverty. The engine of poverty reduction is the 6.5 percent rate increase in social welfare, while adjustments for taxpayers fall slightly short of the minimum needed for wage indexation. The modest child income package generally maintains payments in line with wage growth, with only a small additional benefit for children in poverty.

The scale of resources available in Budget 2008 makes substantial income redistribution and a decisive impact on income poverty difficult to achieve. Looking forward, the achievement of poverty policy targets in the Programme for Government and the National Action Plan for Social Inclusion will depend on additional resources being sourced either from economic growth or from structural reform of the tax system, including indirect taxation, capital taxation and new green taxes. The proposed Commission on Taxation can play an important role in progressing these reform issues.

Finally, this analysis highlights the role of the SWITCH model in understanding the distributive and poverty impact of budgetary policy, and thus in implementing official poverty impact assessment guidelines.





Bridgewater Centre, Conyngham Road, Islandbridge, Dublin 8

Tel: 01 670 6746 Fax: 01 670 6760 Email: info@combatpoverty.ie Website: www.combatpoverty.ie