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Budget 2022

Distributional Analysis of Budget 2022 Tax and Welfare Measures

Prepared by the Department of Finance
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Distributional Analysis of Budget Tax and Welfare Measures

Introduction

The June 2020 Programme for Government *Our Shared Future* provides a commitment to developing a process of budget and policy proofing as a means of advancing social solidarity, equality of opportunity, and reaching ecological harmony and economic equity.[1] The Programme for Government further commits to focus any tax rises on behaviours with negative externalities such as carbon tax. Using the ESRI's microsimulation SWITCH tax-benefit model and indirect taxes satellite model ITSim, the distributional impact of tax and welfare measures implemented as part of Budget 2022 are estimated below. [2]

The net impact includes the effects of direct tax measures, changes in indirect tax and the package of welfare measures. Overall, the impacts of these measures on disposable income are significant. In net terms, all households would experience an average gain in weekly disposable income as a result of the budget package, with the overall impact being broadly progressive in nature. Estimates indicate that a welfare package comprising rises in the increase for qualified children, fuel allowance and living alone allowance can offset the regressivity of a higher carbon tax.

Policies analysed

- The following income tax measures are included: an increase in the Personal, Employee and Earned Income Tax Credit from €1,650 to €1,700, an increase in the Standard Rate Cut-Off Point by €1,500, an increase in the income threshold for the 2 per cent rate of USC from €20,687 to €21,295. In terms of indirect taxes, a €7.50/ tonne increase in the rate of carbon tax bringing the rate to €41 per tonne, together with a €0.50 increase in excise on cigarettes are shown.

- The welfare package includes a €5 increase in weekly payments for working and pension age recipients, with a proportionate increase for qualified adults and those on reduced rates of payments being modelled.

- The welfare package also comprises a further €2/week rise in the Increase for Qualified Child (IQC) payment for the under 12s and €3/week increase for the over 12s, a €10 increase for all 8 bands in the income threshold of the Working Family Payment (WFP), a €3/week increase in the Living Alone Allowance (LA), and a €5/week increase in the Fuel Allowance (FA). It also includes an increase in the income disregard of the Carer's Allowance from €332.50 to €350 for a single person and from €665 to €750 for a couple and an increase in the earnings limit on Disability Allowance from €350 to €375.

- The following changes cannot be directly modelled in Switch 1.4 and therefore are not shown below: changes in the VRT rate, Remote Working Relief, Parent's Benefit, Treatment Benefit, Farm Assist, the equalisation of the Back to School Clothing and Footwear Allowance for one and two parent households, the increase in the Capital Disregard for Carer's Allowance from €20,000 to €50,000 and the increase in the general weekly means disregard for Disability Allowance from €2.50 to €7.60.

[1] Available at: https://www.gov.ie/en/publication/7e05d-programme-for-government-our-shared-future/

[2] This material was prepared by the Department of Finance with input from the Department of Public Expenditure & Reform.

Estimated distributional impacts

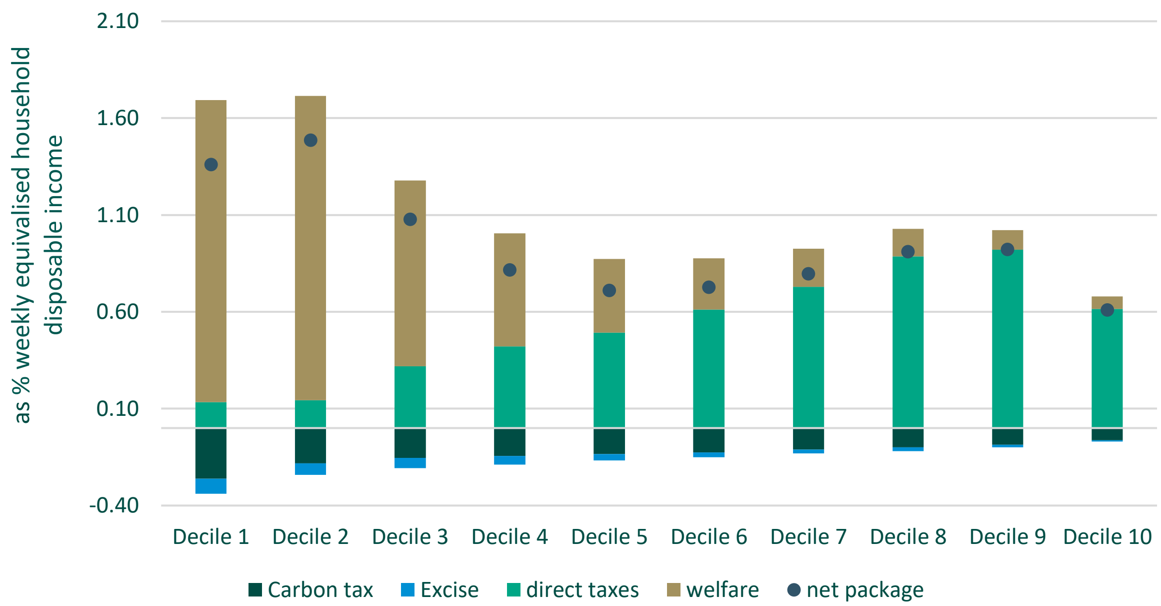
- In net terms, households experience an average gain in weekly disposable equivalised income of 0.85 per cent, with the overall impact being broadly progressive as shown in Figure 1.[3]

- The net package is shown to benefit all income levels, with equivalised disposable income increasing for all deciles. Overall, average impacts on net disposable incomes are estimated in the range of 1.3 per cent for the first three deciles, with the income of the remaining seven deciles increasing in the region of 0.8 per cent. Deciles 1 and 2 show the strongest gains, largely on account of the working age benefits and pensions.

- The average gain from direct tax measures is a 0.6 per cent increase in weekly disposable income, with proportionately greater gains experienced by households in deciles 7-9 of the income distribution.

- For indirect taxes, the increases in carbon tax and excise duties are regressive, however, as a result of the overall budget package, particularly the increases in welfare, these regressive impacts are offset by increases in disposable income in all deciles, in particular in the first three income deciles.

Figure 1: Change in Household Disposable Income by income decile, per cent

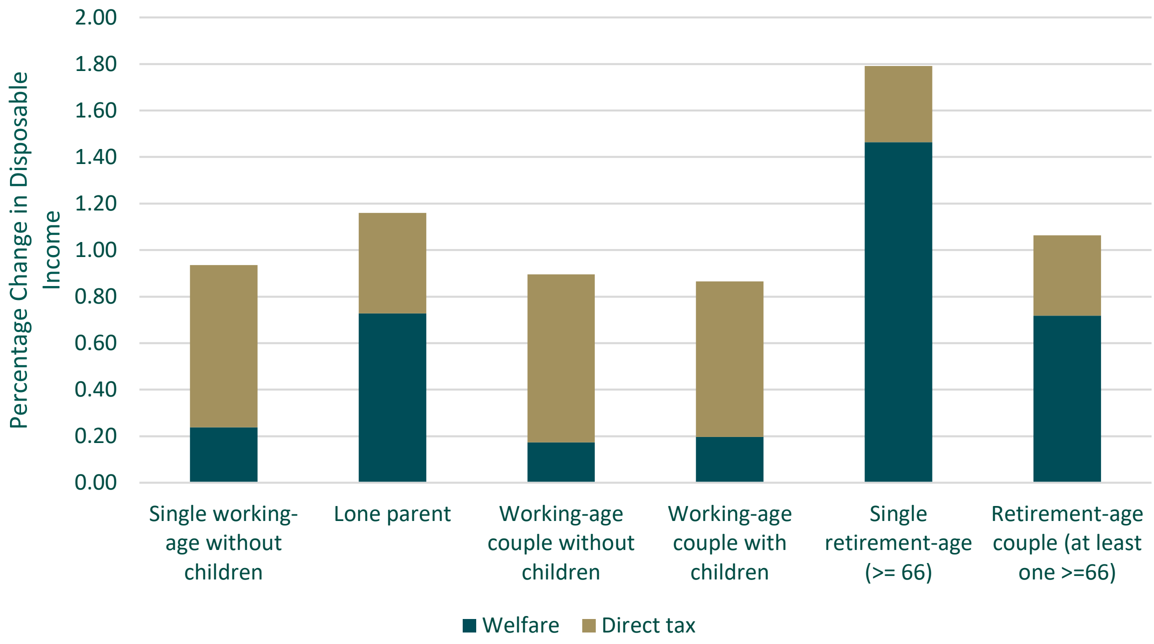


Source: Department of Finance calculations using ESRI's SWITCH 1.4 micro-simulation programme and ITSim indirect taxes satellite model.

[3] Equivalisation adjusts household income on the basis of household size and composition.

- By family type (Figure 2) income gains from the welfare package are highest for both single persons and couples of retirement age and lone parents. Income gains from changes to direct tax are highest for working age couples with and without children.

Figure 2: Change in weekly Disposable Income by Family Type, per cent



Source: Department of Finance calculation using ESRI's SWITCH 1.4 micro-simulation programme

Caveats

- Estimates are shown on a static 'overnight' basis and do not account for any behavioural response to the announced policy changes.

- These estimates are based on early October Pandemic Unemployment Payment (PUP) and Employment Wage Subsidy Scheme (EWSS) claims embedded within version 1.4 of SWITCH, reflecting rates of payment as of 7th September 2021.

- Changes to excise duties and carbon tax are modelled assuming a pre-COVID-19 relationship between income and expenditure by decile within ITSim.

- No account is taken of timing issues e.g. delayed introduction of carbon tax on home fuels, any future potential reversals in VAT reductions, or any changes to the nature, rate or duration of EWSS measures. The increase in the income disregard for Carer's Allowance and earnings limit on Disability Allowance, although due to take effect from June 2022, are modelled for the full year. As for all policy measures, including carbon tax changes, SWITCH 1.4 does not model partial-year effects.

- For a complete picture of the distributional impact of budget measures, the above impacts would need to be considered in conjunction with the significant changes to public expenditure in the areas of health and education etc.