Rialtas na hÉireann
Government of Ireland

Budget 2021

Distributional Analysis of Budget 2021 Tax and Welfare Measures

Prepared by the Department of Finance
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Irish Government Economic Evaluation Service

Distributional Analysis of Budget 2021 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. 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 2021 are estimated. This material was prepared by the Department of Finance with input from the Department of Public Expenditure & Reform.

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. Measures along the lines outlined below are 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 Earned Income Tax Credit from €1,500 to €1,650 (equalising this with the provision for PAYE earners), and an increase in the income threshold for the 2 per cent rate of USC from €20,484 to €20,687. In terms of indirect taxes, a €7.50/ tonne increase in the rate of carbon tax bringing the rate to €33.50 per tonne, together with a restoration of the 9 per cent VAT rate for the hospitality sector and a €0.50 increase in excise on cigarettes are shown.

- The welfare package comprises a further €2/week rise in the Increase for Qualified Child (IQC) payment for the under 12s and €5/week increase for the over 12s, the removal of the earnings threshold for the One Parent Family Payment (OPFP), a €10 increase for the first three bands in the income threshold on the Working Family Payment (WFP), a €5/week increase in the Living Alone Allowance (LA), and a €3.50/week increase in the Fuel Allowance (FA). It also includes a €20 increase in the Disability Allowance income disregard, an increase in the Carer's Support Grant by €150 per year, and 3 additional weeks Parent's Benefit.

- Changes in the VRT regime together with changes in VRT rate, the dependent relative tax credit, island allowance, and widowed/surviving civil partner grant cannot be directly modelled in SWITCH 1.3 and therefore are not shown below.

Estimated distributional impacts

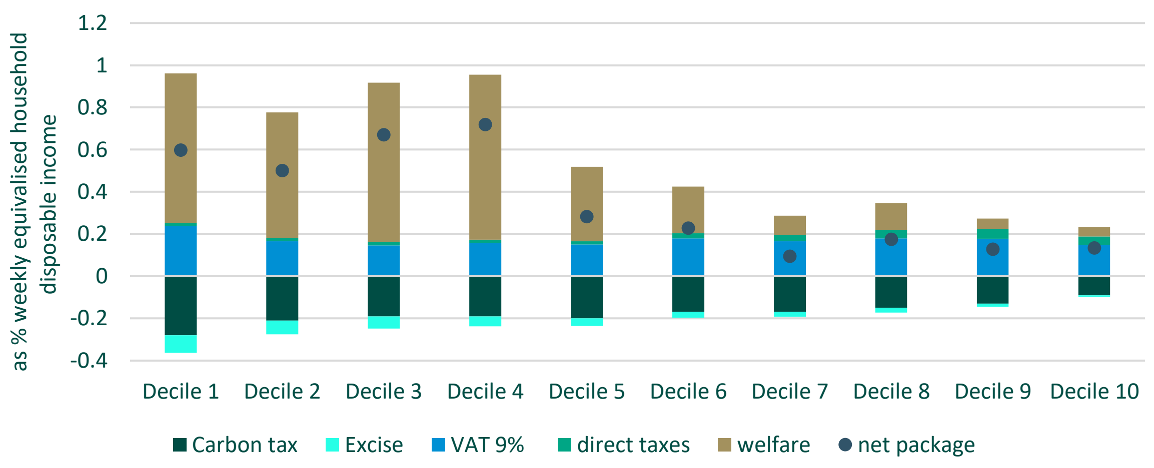
- In net terms, households would experience a modest average gain in weekly disposable equivalised income on account of these policy measures as shown in Figure 1. Equivalisation adjusts household income on the basis of household size and composition

- The average gain from *direct tax measures* is a modest 0.03 per cent increase in weekly disposable income, with proportionately greater gains experienced by households in the top three income deciles.

- For *indirect taxes*, the reduction in the VAT rate of the hospitality sector to 9 per cent is broadly progressive, with households in the first income decile gaining proportionately more than those in higher deciles. Increases in excise duties and carbon taxes are regressive. Whilst all household income deciles lose out on average in relation to these indirect taxes, their regressive impacts are estimated to be offset by increased disposable income in the first four deciles in particular owing to the welfare measures.[1]

- The net package (Figure 1) 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 0.5 per cent to 0.7 per cent for the first four deciles, with the income of the remaining six deciles increasing in the region of 0.17 per cent. Deciles 3 and 4 register the strongest gains, largely on account of the increases in Living Alone Allowance.

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



Source: Department of Finance calculations using ESRI's SWITCH 1.3 micro-simulation programme and ITSim indirect taxes satellite model.

[1] Figures may not sum due to rounding owing to interactions across policy measures.

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

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

Source: Department of Finance calculation using ESRI's SWITCH 1.3 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 end-June unemployment outturns embedded within version 1.3 of SWITCH. Changes to the EWSS as announced in July do not impact on disposable income levels as currently modelled within SWITCH, however, the impact of the changes to PUP announced in September are taken into account.

- Carbon tax impacts are consistent with the 'no compensation scenario' described in the ESRI's paper *Carbon Taxes, Poverty and Compensation Options* (October 2020). Increases to VAT and excise duties are, however, 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 the PUP and EWSS measures.

- 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 on health in particular.

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