

# Social impact assessment of the main welfare and tax measures for 2015

January 2015

This social impact assessment examines the main welfare and tax measures for 2015, including the new water charges package.

Social impact assessment is an evidence-based methodology which estimates the likely effects of welfare and tax policies on households across income levels and social groups.

The assessment supports the implementation of the national social target for poverty reduction and contributes to public understanding of the distributive impact of budgetary policy.

The assessment was prepared by the Department of Social Protection, which is responsible for the welfare component of the Budget. It is based on the tax/welfare microsimulation model SWITCH developed by the Economic and Social Research Institute. Responsibility for the analysis rests solely with the Department.



## Main findings

- For the first time since the economic crisis, budgetary policy will result in an increase in average household incomes of 0.7 per cent (equivalent of €6 per week).
- The distributive impact is uneven, with higher than average gains for better-off quintiles. Middle and lower income quintiles gain less than the average, with the smallest gain in the bottom quintile.
- The distributive impact varies according to the component measures. Welfare increases favour lower income households, while tax reductions are more beneficial to middle and higher income groups.
- The introduction of the water charge will result in losses for all households, through the scale is reduced by the water conservation grant.
- The household types who benefit the most are those with someone earning or retired. Earning couples with children generally do better.
- Non-earning households fare least well, with one category, non-earning couples without children, recording a small loss (-0.2 per cent).
- There is no significant change in the at-risk-of-poverty rate as the income threshold increased. This suggests that social transfers continue to perform strongly in reducing poverty.
- There is a marked contrast between the impact of the 2015 and 2014 budgetary measures as gains replace losses, with the most significant improvements for the poorest and richest households.

## Introduction

This briefing presents the social impact assessment of the main welfare and tax measures for 2015, including the water charge.

Social impact assessment is an evidence-based methodology to estimate the likely distributive effects of policy proposals on income and social inequality. It is a widely used tool at the European level.<sup>i</sup> Though relatively new in the Irish context, it builds on poverty impact assessment and is similar in concept to 'equality budgeting'.<sup>ii</sup>

The assessment supports the implementation of the national social target for poverty reduction, which is to reduce consistent poverty to 4 per cent by 2016 and to 2 per cent or less by 2020. It also informs Government policy on improving living standards among low and middle income families and reducing inequality and improving poverty outcomes.<sup>iii</sup>

Social transfers and taxes have a key role in reducing income inequality and preventing poverty. CSO data show that social transfers (excluding pensions) reduced the at-risk-of-poverty rate from 49.8 per cent to 15.2 per cent in 2013, thereby lifting a third of the population out of income poverty.<sup>iv</sup>

This briefing was prepared by the Department of Social Protection, which is responsible for the welfare component of the Budget. Its publication is intended to inform public understanding of the distributive impact of budgetary policy.<sup>v</sup>

## Methodology

The assessment uses a tax-welfare simulation model developed by the Economic and Social Research Institute (ESRI) known as SWITCH.<sup>vi</sup> The model simulates the impact of changes in welfare and income tax for a representative sample of 5,000 households, drawn from the CSO *Survey on Income and Living Conditions*, with the data updated to reflect trends in population, employment and incomes.<sup>vii</sup> Responsibility for the analysis rests solely with the Department of Social Protection.

The assessment covers the main welfare and tax measures announced in Budget 2015, along with the revised water charges package for implementation in 2015.

Certain items are not included in the assessment, such as additional expenditure on labour market initiatives<sup>viii</sup> and some tax changes. Furthermore, the assessment does not include non-welfare expenditure measures for 2015, such as healthcare, education and social housing. The Department of Social Protection and the ESRI are working with line departments to improve the capacity of the SWITCH model to support such analyses.

Work incentives are a significant element of the policy debate on unemployment and poverty.<sup>ix</sup> Budget 2015 contained a number of measures (income tax, USC and back to work family dividend) which are designed to have a positive impact on work incentives. In addition, the new housing assistance payments, due for national roll-out in 2015, will remove the barrier to full-time work for long-term recipients of rent supplement. Work is ongoing to quantify these impacts as part of the ESRI SWITCH research programme.

## The main welfare and tax measures

The measures included in the assessment are presented in table 1. There are three welfare measures included in the analysis, with full-year expenditure of €149 million. The tax items include income tax rate and band changes and USC threshold and rate changes, with a total annual expenditure of €642 million. The final component relates to the introduction of water charges, with billed domestic income estimated at €271 million per annum and a water conservation grant costing €130 million.

The assessment contains the following:

- the distributive impact of the combined and component measures
- the impact on household types
- the impact on at-risk-of-poverty
- the comparative impact of the 2015 and 2014 measures.

The comparator policy is the 2014 policy which freezes taxes and welfare payments in nominal terms.<sup>x</sup> Distributive impact is measured by income quintile (five equally sized groups ranked by equivalised income),<sup>xi</sup> by 14 family types (differentiated by composition and employment status) and by at-risk-of-poverty, using the 60 per cent median income threshold, disaggregated by social group.<sup>xii</sup>

**Table 1: Summary of main welfare & tax measures for 2015 & official costs**

Measures	Official cost €m
<b>Welfare total</b>	<b>149</b>
<ul style="list-style-type: none"> <li>• Increase in child benefit of €5 per month</li> <li>• Increase in living alone allowance by €1.30 per week</li> <li>• A 25% Christmas Bonus paid in December 2014 to recipients of long-term social welfare payments (minimum €20)</li> </ul>	72 12 65
<b>Tax total</b>	<b>642</b>
<ul style="list-style-type: none"> <li>• Increase in the standard rate income tax band of €1,000 per annum and reduction in the higher rate of income tax to 40%</li> <li>• Increase in the USC thresholds and changes to USC rates including the introduction of a new upper rate of 8%</li> </ul>	405 237
<b>Water charges package<sup>xiii</sup></b>	
<ul style="list-style-type: none"> <li>• Capped water charge of €160 for one-adult households and €260 for multi-adult households</li> <li>• Water conservation grant for households registering with Irish Water</li> </ul>	-271 130

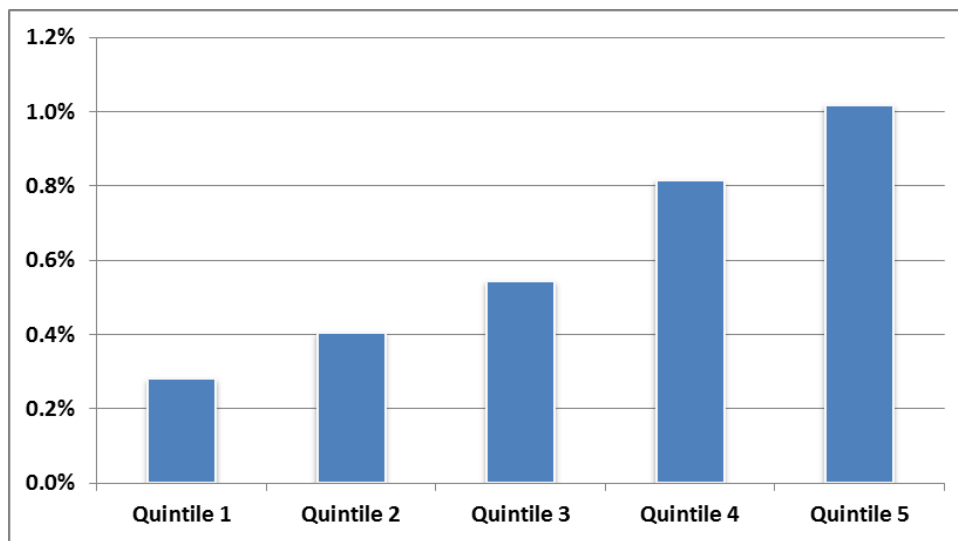
Social expenditure measures not included in the analysis include additional resources for health, education and social housing. Full details of all the budgetary measures can be found in the Budget 2015 documentation.<sup>xiv</sup>

## Distributive impact of the composite 2015 measures

Based on the SWITCH model, the gain in average income as a result of the budgetary measures is 0.7 per cent of average household income, the equivalent of €6 per household per week. This is the first improvement in household incomes since the introduction of fiscal consolidation measures due to the economic crisis.

Diagram 1 shows the distributive impact by income quintile. The greatest gains are for the highest income quintile at 1 per cent, followed by the fourth quintile at 0.8 per cent. All other quintiles gain less than the average, at between 0.5 per cent (3<sup>rd</sup> quintile), and 0.3 per cent (bottom quintile).

**Diagram 1: Distributive impact of the composite 2015 measures**  
(Percentage gain in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

Table 2 summarises the impact of the three budgetary components using SWITCH. The welfare measures result in a gain of 0.2 per cent in average household income at an aggregate cost of €122 million. The income tax and USC measures have the greatest impact, with an average household gain of 0.8 per cent at an

aggregate cost of €615 million (four times the welfare component). The water charges package gives rise to an average loss of 0.3 per cent in household income, generating aggregate costs of -€187 million.<sup>xv</sup> Overall, the combined gain is 0.7 per cent, with a total aggregate cost of €550 million (SWITCH estimate).

**Table 2: SWITCH estimate of impact of main welfare and tax measures for 2015<sup>xvi</sup>**

Measure	% Change	Aggregate cost
<b>Welfare</b>	0.2%	€122m
<b>Income tax/USC</b>	0.8%	€615m
<b>Water charges package</b>	-0.3%	-€187m
<b>Total</b>	0.7%	€550m

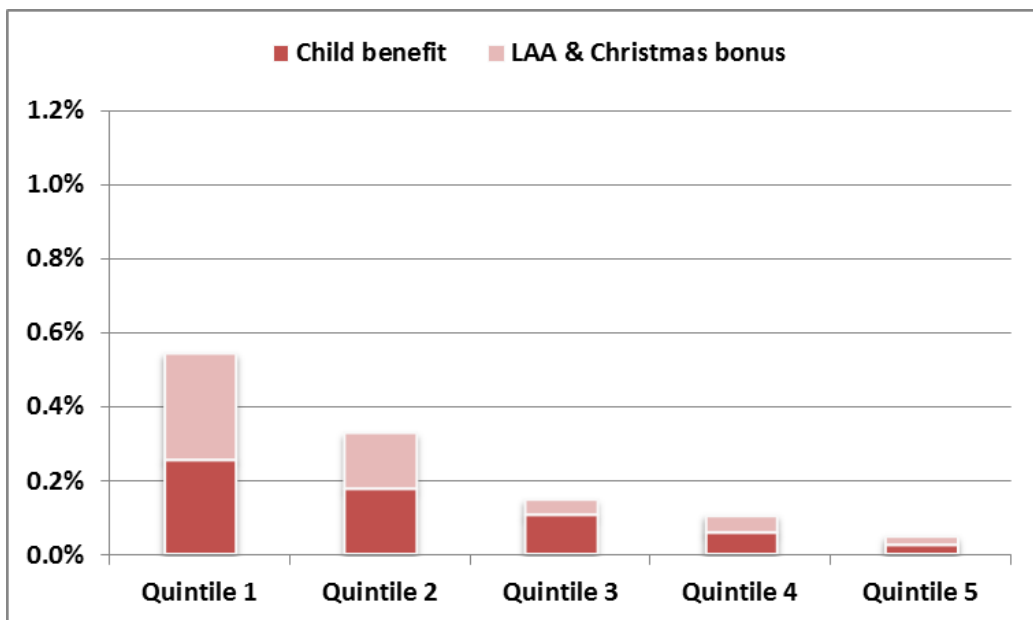
Source: SWITCH, the ESRI tax-benefit model

## Distributive impact of the welfare measures

Diagram 2 shows the distributive impact of the welfare measures, distinguishing between higher child benefit and targeted welfare rate increases (i.e. the living alone allowance and 25 per cent Christmas bonus). Each contributes 0.1 per cent to the increase in household income of 0.2 per cent. As child benefit only affects households with children (a quarter of all households), their average gain from this measure is higher, at c 2.5 per cent.

The bottom quintile gains most at 0.5 per cent, with slightly more derived from welfare rate increases. The second quintile gains 0.3%, with child benefit contributing more. There are much smaller gains in the better-off quintiles, mainly derived from universal child benefit. The fact that child benefit is a flat rate increase gives rise to a progressive impact.

**Diagram 2: Distributive impact of the welfare measures**  
(Percentage gain in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

### Distributive impact of income tax and USC measures

The tax changes in Budget 2015 deliver an average increase in household income of 0.8 per cent, four times the welfare effect. The average gain from the income tax measures is 0.5 per cent, while the average gain from USC is 0.3 per cent. Diagram 3 shows the distributive impact by income quintile. Not surprisingly, the tax changes favour better-off households, as they are the ones contributing most in tax.<sup>xvii</sup> However, there are significant differences between the two tax components. The USC measures (light green bar) impact positively on all income quintiles, but

especially the middle income households (2<sup>nd</sup> to 4<sup>th</sup> quintiles) which gain 0.5 per cent. The smallest USC gain is in the top quintile, which reflects the clawback effect of the increase in the highest USC rate. By contrast, the impact of the income tax measures (dark green bar) is concentrated on the top quintile, which gains 1 per cent, twice the average. The 3<sup>rd</sup> and 4<sup>th</sup> quintiles gain to a much lesser extent, while there is minimal benefit for the bottom two quintiles.

**Diagram 3: Distributive impact of the income tax and USC measures**  
(Percentage gain in household income by equivalised income quintile)



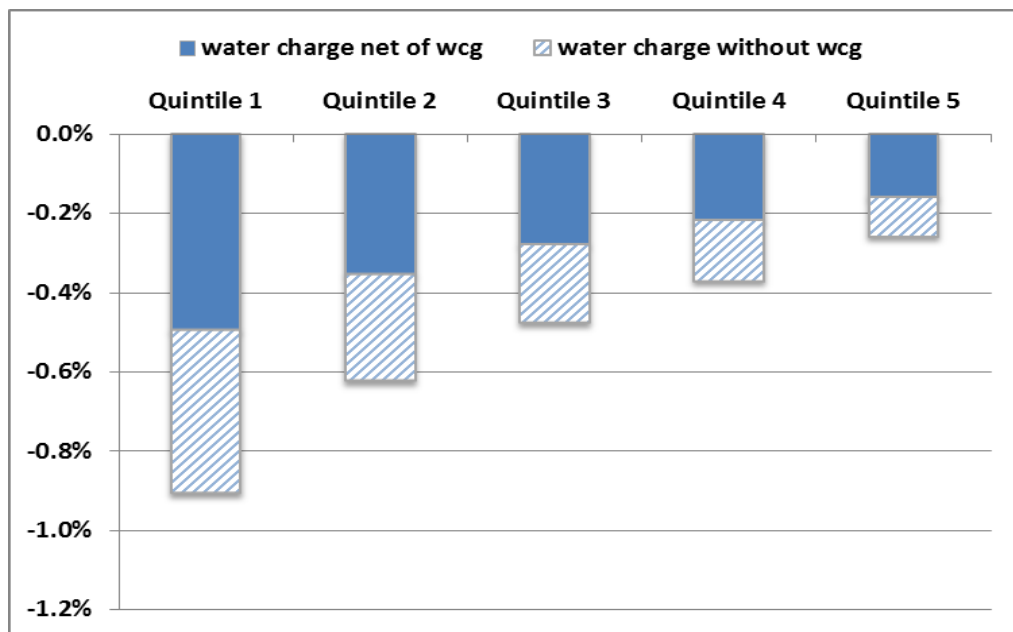
Source: SWITCH, the ESRI tax-benefit model

## Distributive impact of the water charges package

The water charges package consists of a two-tier capped water charge and the water conservation grant. The average loss from the water charges is -0.4 per cent of average household income. This is almost halved by the water conservation grant, to less than -0.3 per cent.<sup>xviii</sup> Diagram 4 shows the distributive impact of the water charges package including the water conservation grant. The capped water charge has a

greater impact on lower income households, with the bottom quintile losing 0.9 per cent compared to 0.3 per cent for the top. The water conservation grant (light blue bar) significantly reduces the extent of the losses, especially in the bottom quintiles. These losses may be further reduced depending on whether both water services are used and the consumption patterns in households.

**Diagram 4: Distributive impact of the water charges package**  
(Percentage change in household income by equivalised income quintile)



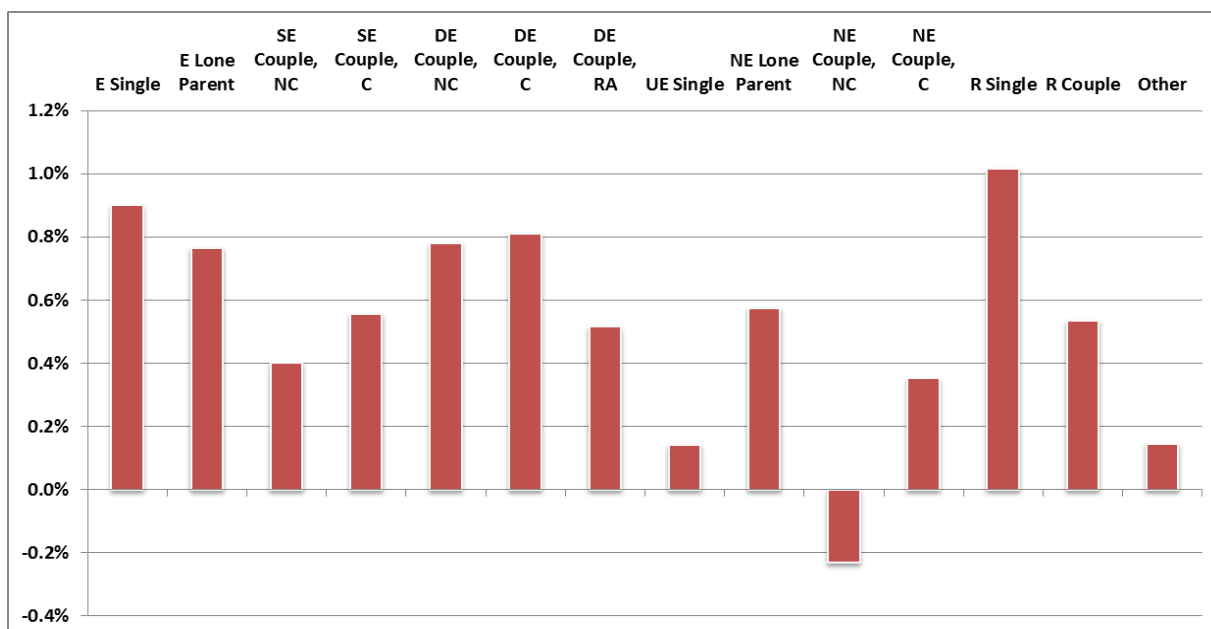
Source: SWITCH, the ESRI tax-benefit model

## Impact on family types

Diagram 5 presents the distributive impact of the composite 2015 measures on family types.<sup>xix</sup> The main findings are:

- the biggest beneficiaries are retired single person households, with an average gain of 1 per cent
- single earners, earning lone parents and dual earning couples fare above average, gaining around 0.8 per cent.
- Generally, households with children gain more than those without, reflecting the child benefit increase and the capping of the water charges.
- non-earning households do least well, while unemployed couples without children record a loss of -0.2 per cent.

**Diagram 5: Distributive impact on families of the composite 2015 measures**  
(Percentage change in income by family type)\*



Source: SWITCH, the ESRI tax-benefit model

\* E=employed; UE=unemployed; NE=non-earning; R=retired; SE=single earner; DE=dual earner; C=children; NC=no children; RA=relative assisting

## Impact on at-risk-of-poverty

There is no significant change in the at-risk-of-poverty rate for the total population or for sub-groups, though the bottom incomes increased. This is accounted for by the marginal rise in the at-risk-of-poverty

threshold (0.4 per cent). Overall, the strong performance of social transfers in alleviating income poverty (up to 70 per cent reduction) is likely to be maintained for 2015.



### Comparative impact 2015 vs 2014

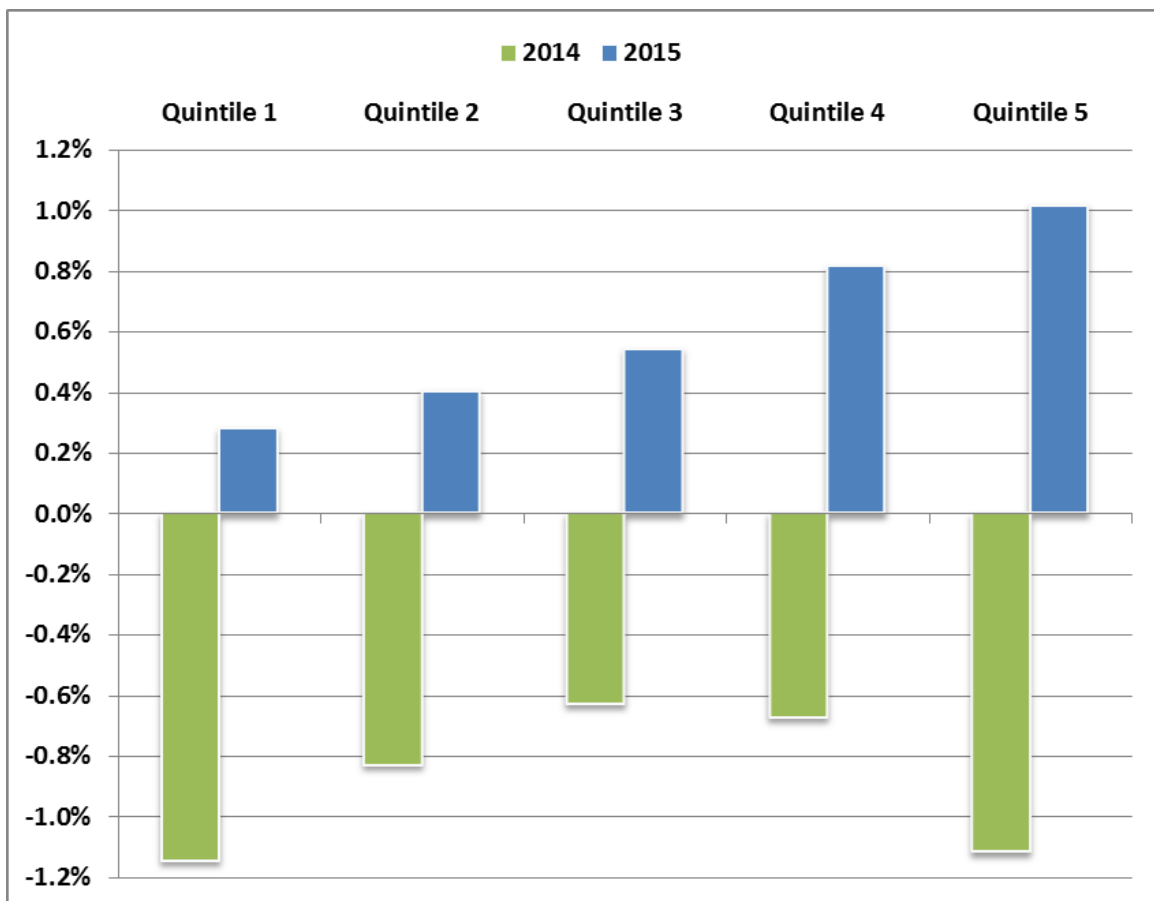
Finally, the distributive impact of the composite budgetary package for 2015 is compared with the 2014 measures. There is a marked difference in the overall distributive impact: a gain of 0.7 per cent in 2015 compared to a loss of 0.8 per cent in 2014.

The contrast in distributive impact between 2015 and 2014 is greatest at the top and bottom of the income distribution (diagram 6). Thus, a loss of 1.1 per cent for the bottom quintile in 2014 is replaced by a gain of 0.3

per cent in 2015. Similarly, the top quintile goes from a loss of 1.1 per cent in 2014 to a gain of 1 per cent in 2015. For middle income groups, the scale of the transformation is not as dramatic.

Over the two years combined, many households will still show an overall loss in income. Looking at the entire period since the commencement of the economic crisis (2009-2015), ESRI analysis shows that the average loss in household income is over 10 per cent.<sup>xx</sup>

**Diagram 6: Distributive impact of composite 2015 measures compared with 2014**  
(Percentage change in household income by equivalised income quintile)



Source: SWITCH, the ESRI tax-benefit model

## Endnotes

- <sup>i</sup> See: <http://ec.europa.eu/social/main.jsp?catId=89&langId=en&newsId=935&furtherNews=yes>
- <sup>ii</sup> See: [www.equalitybudgeting.ie](http://www.equalitybudgeting.ie)
- <sup>iii</sup> *Statement of Government Priorities 2014-2016* <http://www.merrionstreet.ie/en/wp-content/uploads/2014/07/Statement-of-Government-Priorities-Final-110714.pdf> ; Department of Finance (2013), *A Strategy for Growth. Medium-term Economic Strategy*. Dublin: Stationery Office, <http://mtes2020.finance.gov.ie/>
- <sup>iv</sup> CSO *SILC 2013 results*. Excluding pensions, social transfers reduce the at-risk-of-poverty rate from 38.4 per cent to 15.2 per cent. This equates to a poverty reduction effect for social transfers of 60 per cent. This is the best performance of all EU member states and is 1.7 times the EU average (see [Eurostat website](http://ec.europa.eu/eurostat)).
- <sup>v</sup> See: <http://www.socialinclusion.ie/NPT.html>
- <sup>vi</sup> Simulating Welfare and Income Tax Changes
- <sup>vii</sup> Information on the design, underlying data and model construction can be found at [http://www.esri.ie/research/research\\_areas/taxation-welfare-and-pens/](http://www.esri.ie/research/research_areas/taxation-welfare-and-pens/) .
- <sup>viii</sup> These include the new Back to Work Family Dividend, JobPlus and JobPath.
- <sup>ix</sup> Savage, M., Callan, T., Keane, C., Kelly, E. and Walsh, J.R. (2014), *Welfare Targeting and Work Incentives*, Budget Perspectives 2015 Paper 3, Dublin: ESRI. See: <http://esri.ie/UserFiles/publications/JACB201239/BP201503.pdf>
- <sup>x</sup> Other comparators can also be used, such as a wage indexed policy as used by the ESRI. See: [http://www.esri.ie/UserFiles/publications/QEC2014Win\\_SA\\_Keane.pdf](http://www.esri.ie/UserFiles/publications/QEC2014Win_SA_Keane.pdf)
- <sup>xi</sup> The income ranges of the quintiles, using weekly equivalised disposable income, is as follows: quintile 1: <€256; quintile 2: €256-€348; quintile 3: €348-€445; quintile 4: €445-€617; quintile 5: >€617.
- <sup>xii</sup> This includes the impact by lifecycle and gender. Consideration of the impact on people with disabilities or ethnic minorities is not technically possible. It is hoped to rectify this in future social impact assessments.
- <sup>xiii</sup> The estimate of the billed domestic income for Irish Water from households availing of one or both water services is provided by the Department of Environment, Community and Local Government *Fact Sheet 1: Financing Irish Water* (see <http://www.envron.ie/en/PublicationsDocuments/FileDownload,39557,en.pdf>). The water conservation grant is included in the 2015 Revised Estimates for Public Services (See: <http://per.gov.ie/wp-content/uploads/Master-Copyv1.pdf> – vote 34, line B-6, page 153).
- <sup>xiv</sup> See: <http://www.welfare.ie/en/downloads/budfact15.pdf> and <http://budget.gov.ie/Budgets/2015/2015.aspx>
- <sup>xv</sup> As the water charges package is not expected to affect all households, a pro-rata estimate of 79 per cent of the likely net cost per household is applied in the SWITCH model. Minor adjustments in this estimate are not expected to alter the distributive impact of the package.
- <sup>xvi</sup> Note the figures presented from the SWITCH model take into account tax and welfare expenditure offsets against the Budget measures. Percentage change and savings figures quoted are rounded.
- <sup>xvii</sup> The top 24 per cent of earners pay 80 per cent of tax. See: [http://www.budget.gov.ie/Budgets/2015/Documents/Fairness\\_infographic.pdf](http://www.budget.gov.ie/Budgets/2015/Documents/Fairness_infographic.pdf)
- <sup>xviii</sup> The reduction is 0.18 per cent, from -0.43 per cent to -0.25 per cent.
- <sup>xix</sup> In some cases, a number of family types may live in the same household.
- <sup>xx</sup> Keane, C., Callan, T., Savage, M., Walsh, J.R., and Colgan, B. (2014), *Distributional Impact of Tax, Welfare and Public Service Pay Policies: Budget 2015 and Budgets 2009-2015*. See: [http://www.esri.ie/UserFiles/publications/QEC2014Win\\_SA\\_Keane.pdf](http://www.esri.ie/UserFiles/publications/QEC2014Win_SA_Keane.pdf)