



# POLICY SUBMISSION

**Targeting poverty: Submission on  
Budget 2002 to the Minister for Social,  
Community and Family Affairs**

**October 2001**

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### Summary of Agency recommendations for Budget 2002

Issue	Proposal	Cost	
		Welfare (£m)	Tax (£m)
Welfare payments	<u>Personal rates</u>		
	<ul style="list-style-type: none"> <li>Indexation of welfare payments in line with 10.8% wage growth (lowest payment rises from £84 to £93.10)</li> </ul>	536.4	
	<ul style="list-style-type: none"> <li>Increase lowest (indexed) payment by a further £4.90 to £98 on adequacy grounds</li> </ul>	58.8	
	<u>Qualified adult allowance</u>		
	<ul style="list-style-type: none"> <li>Increase the basic adult dependant payment to 68.60 to reach 70% of (enhanced) personal rate (£98)</li> </ul>	24	
Child income support	<u>Child benefit</u>		
	<ul style="list-style-type: none"> <li>Increase (indexed) child benefit to £92.50 per month/£21.35 per week and £111/£25.62 for higher rate (3<sup>rd</sup> + child), in line with government plan</li> </ul>	245.1	
	<ul style="list-style-type: none"> <li>Increase higher rate by further £19 to £130 per month/£30 per week on adequacy grounds</li> </ul>	43	
	<u>Child dependant allowance</u>		
	<ul style="list-style-type: none"> <li>Increase lowest child dependent payment from 13.20 to £15.20 per week as part of two-year strategy to equalise all payments at £17, on adequacy grounds</li> </ul>	11.5	
	<ul style="list-style-type: none"> <li>Freeze child dependant allowance rates, in line with government policy</li> </ul>	(21)	
	<ul style="list-style-type: none"> <li>Extend child dependant allowance to 22 years for those in full-time education, in line with PPF</li> </ul>	cost not available	
Personal taxation	<u>Tax allowances/bands</u>		
	<ul style="list-style-type: none"> <li>Indexation of allowances/bands in line with 10.8% wage growth (personal allowance goes from £5,500 to £6,094 and PAYE allowance from £2,000 to £2,216)</li> </ul>		659.4
	<u>Employee PRSI</u>		
	<ul style="list-style-type: none"> <li>Abolish the threshold for employee's PRSI, to enhance progressivity of tax system</li> </ul>		(108)
	<u>PAYE allowance</u>		
	<ul style="list-style-type: none"> <li>Increase (indexed) PAYE allowance by a further £334 to £2,550 in line with PPF commitment to remove minimum wage from tax net (91%)</li> </ul>		77.4
Other measures	<ul style="list-style-type: none"> <li>Introduce targeted savings scheme for low-income households</li> </ul>	e60	
	<ul style="list-style-type: none"> <li>Improve direct provision for asylum seekers</li> </ul>		
	<ul style="list-style-type: none"> <li>Extend eligibility guidelines for the medical card</li> </ul>		
	<ul style="list-style-type: none"> <li>Expand schools meals.</li> </ul>		
	<ul style="list-style-type: none"> <li>Increase clothing &amp; footwear allowance</li> </ul>		
	<ul style="list-style-type: none"> <li>Expand school book scheme</li> </ul>		

**Select examples of proposed budgetary changes**

<i>Category</i>	<i>Current value</i>	<i>Proposed value</i>	<i>% change</i>
<b>Basic personal welfare rate</b> <b>Qualified adult allowance</b> <b>Couple on basic rate</b> Old Age Pension personal rate (NC) Old Age Pension personal rate (C)	£84 per week £54 pw £138 pw £95.50 pw £106 pw	£98 £68.60 £166.60 £105.80 £117.40	17% 27% 21% 11% 11%
<b>Child benefit (standard rate)</b>  Child benefit for 3 <sup>rd</sup> & subsequent child  Lowest child dependant allowance Combined child income support Combined child income support (3 <sup>rd</sup> child)	£15.58 pw (£67.50 per month) £19.85 pw (£86 per month) £13.30 pw £28.75 pw £33.05 pw	£21.35 (£92.50) £30 (£130) £15.20 £36.55 £45.20	37%  51%  15% 27% 37%
<b>Personal tax allowance</b> PAYE allowance Combined allowances EE PRSI threshold Higher rate tax band	£5,500 per year £2,000 py £7,500 py £28,250 py £20,000 py	£6,094 £2,550 £8,644 abolished £22,160	11% 28% 16%  11%

## 1. Targeting poverty: the policy challenge for Budget 2002

This submission on Budget 2002 is made in accordance with the Agency's statutory role to advise the Minister for Social, Community and Family Affairs on all aspects of economic and social policy which pertains to poverty. The Budget, through its policies on welfare and taxation, is crucial in tackling income inequality and encouraging employment. The submission builds on previous Agency statements on budgetary policy<sup>1</sup> and uses the ESRI tax/welfare simulation model (SWITCH)<sup>2</sup> to calculate the distributive and poverty outcomes of its proposals.

The expectations on Budget 2002 are very high from a poverty perspective, as the Budget coincides with the revision of the National Anti-Poverty Strategy (NAPS) and the development of the Irish National Action Plan against poverty and social exclusion (NAPincl) at an EU level. NAPS commits the government to ensuring that the benefits of economic growth are distributed fairly and are used to tackle the underlying causes of poverty and social exclusion. This commitment is reaffirmed in the Programme for Prosperity and Fairness and in policy statements by the Taoiseach and the Minister for Social, Community and Family Affairs.

This submission advocates a strategic approach to tackling poverty in Budget 2002 based on the setting of a specific target for the reduction of income poverty (as is the case for inflation, employment, etc). This would make poverty a central concern of the Budget and would reflect the fact that allowing poverty to persist can lead to major social and economic costs, as well as being morally indefensible. The argument for making poverty a central concern of budgetary policy is outlined in a recent UNICEF analysis of child poverty in rich countries:

*The injustices and inefficiencies of (an) economic-priorities-first and social-needs-later approach have become evident on both national and international stages. Social policy should not be an afterthought. Attempts to reduce poverty, if they are to be even partially successful, demand integrated policy making.<sup>3</sup>*

A strategic approach to poverty should imbue all aspects of Budget 2002, including taxation, public services, employment and economic development.

The submission begins by examining the policy context for tackling poverty in Budget 2002. It then proposes as a starting point in Budget policy the indexation of tax and welfare policies in line with wages. Three policy priorities for Budget 2002 are then outlined relating to the adult welfare rate, child income support and adult welfare dependency. A self-financing reform of personal taxation is also proposed, focused on redistributing resources at the low-paid. A select number of other policy measures are also proposed to tackle poverty. Finally, the redistributive and poverty impacts of the proposed reforms in Budget 2002 are detailed.

## 2. Setting a poverty reduction target for Budget 2002

A key element of NAPS is its global poverty reduction target, which aims to reduce to less than 5 percent households experiencing both income poverty and deprivation of

<sup>1</sup> Combat Poverty Agency (2001), *A fairer deal in Budget 2001* and Combat Poverty Agency (2002), *Analysis of Budget 2001*.

<sup>2</sup> As described in T Callan et al (1998), *Simulating tax and welfare changes*, Dublin: ESRI. All calculations and accompanying commentary are the exclusive responsibility of the Agency and no responsibility for the results is attributed to the ESRI or the authors of the model software.

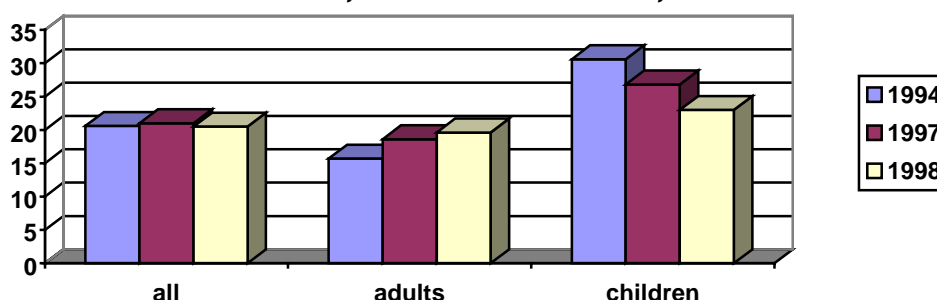
<sup>3</sup> UNICEF (2000), *A league table of child poverty in rich nations*, Innocenti Report Card, 1, UNICEF Innocenti Research Centre, Florence.

basic necessities by 2004 (referred to as 'consistent poverty'). Recent data suggest that the government is on track to meet this target, with 8 percent of households in consistent poverty in 1998, down from 15 percent in 1994 and 9.7 percent in 1997. This target is currently under review and a more ambitious figure is likely to emerge, including a target for reducing relative income poverty.

Building on existing poverty targets, the Agency proposes that Budget 2002 should have as an objective an explicit reduction in income poverty. Reducing income poverty is an essential backdrop to a further fall in consistent poverty, as well as being an important policy objective in its own right. Having an income poverty reduction target for Budget 2002 would give meaning to the NAPS commitment to poverty proof significant policy proposals, including the Budget, with a view to enhancing its poverty reduction effect.<sup>4</sup> Furthermore, with the SWITCH micro-simulation model, it is possible to estimate in advance what the likely income poverty effect will be.<sup>5</sup> While this model does not as yet contain a way of measuring the indirect poverty effects of Budget policy, eg job creation, it does provide a context for further analysis.

In considering an income poverty reduction target for Budget 2002, it is important to take into account the national and EU policy context. Recent Irish trends in poverty are summarised in diagram 1. This shows that income poverty remains stubbornly high: a fifth of the population live in households with less than half average incomes.<sup>6</sup>

**Diagram 1: Trends in relative income poverty (50% mean)  
for individuals, adults and children, 1994-98**



<sup>4</sup> Poverty proofing is the prior assessment of the likely impact of government policies on poverty and on inequalities which lead to poverty, with a view to achieving an enhanced poverty reduction. Poverty proofing of government memoranda involving significant policy proposals is a requirement of the cabinet handbook.

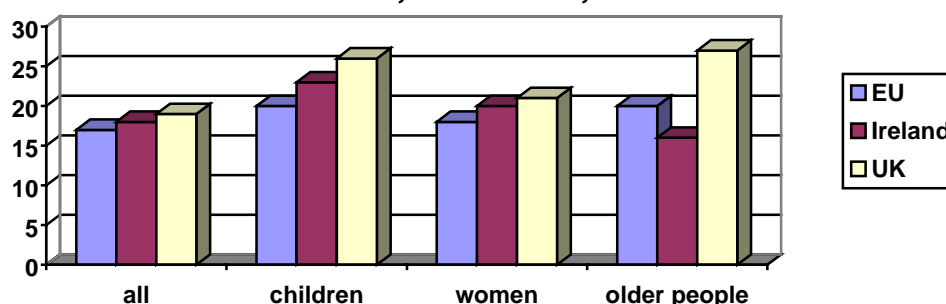
<sup>5</sup> SWITCH enables a more comprehensive poverty-proofing of the Budget than was achieved last year. Then, separate poverty-proofing reviews of the welfare and tax changes were undertaken, which led to double counting of some changes and did not give a complete picture as to the overall effects of the Budget. In addition, the data sources used to inform the tax review were quite limited, being based on examples of various categories of taxpayers over a range of specimen incomes. Third, analyses assumed that budgetary changes could be measured on a no-change scenario, which effectively ignores the incomes losses for welfare recipients arising from inflation, as well as the deterioration in their position relative to those in employment arising from wage growth.

<sup>6</sup> R Layte et al (2001), *Monitoring poverty trends and exploring poverty dynamics in Ireland*, Policy Research Series Number 41, Dublin: Economic and Social Research Institute

The aggregate picture masks a differential risk of poverty as between adults and children. Child poverty has consistently been higher than adult poverty, though the difference has fallen from 100 percent in 1994 to 17 percent in 1998. Other groups at higher risk of poverty are women (32 percent more likely to be poor than men) and older people (118 percent more likely to be poor than adults under 64 years).

Policy on poverty is increasingly framed in a European context, as reflected in the EU initiative on enhanced national policy co-ordination against poverty. A key baseline in setting an Irish target for reducing income poverty is therefore comparative EU data (diagram 2).<sup>7</sup> The most recent (1996) data on individuals below 60 percent of median income show that Ireland's poverty rate is slightly above the EU norm, though below that of the UK. The gap widens for children: the Irish rate of child poverty is 3 percent higher than the EU, though still 3 percent below the UK rate of 26 percent. For female poverty, there is also a differential between Ireland and the EU. Among older people, however, this pattern is reversed, with Ireland having 4 percent fewer older people poor. The UK scores worst for poverty among women and older people.

**Diagram 2: Relative income poverty (60% median)  
for Ireland, EU and UK, 1996**



What lies between these relatively high Irish rates of income poverty? Two factors can be highlighted: unequal income distribution and unemployment.

- In Ireland, the poorest 10 percent of the population account for 3.4 percent of disposable income. By contrast, the richest decile receives a quarter of income, or 7 times more than the poorest. Trends in the 1990s suggest that income disparities have widened, mainly due to a decline in the equalising effect of tax/welfare policy rather than increased earnings dispersion.<sup>8</sup> International data on income distribution ranks Ireland among the more unequal countries. Taking the share of income between richest and poorest quintiles as the key indicator of income distribution, Ireland has a share ratio of 5.6. This is worse than the EU norm of 5.2 and places Ireland with the UK, Spain, Greece and Portugal.<sup>9</sup>
- Employment status is a crucial indicator of poverty. In Ireland, the greatest poverty risks are recorded among households where the reference person is unemployed, ill/disabled or engaged in home duties. This division is accentuated in jobless households<sup>10</sup>, whose members are six times more likely to be poor than those in working households. This poverty-unemployment link is common across

<sup>7</sup> Eurostat (2001), *The social situation in the European Union 2001*, Luxembourg: Office for Official Publications of the European Communities

<sup>8</sup> B Nolan et al (2000), *The distribution of income in Ireland*, Dublin: Oak Tree Press/Combat Poverty Agency

<sup>9</sup> Eurostat (2001), *op cit*

<sup>10</sup> Defined as an 'economically active' household where no one is in employment.

the EU. What differentiates Ireland is the high proportion of jobless households among the population: 7 percent, as compared to 5.8 percent in the EU.<sup>11</sup>

### 3. Key policy issues in targeting poverty in Budget 2002

Two policy issues stand out in framing a Budget which reduces poverty:

- the indexation of welfare payments in line with wages;
- the targeting of additional resources on welfare rather than taxation.

#### 3.1 *Setting an indexation benchmark*

The conventional approach to tax/welfare policy in the Budget is to assume that the starting point is to leave tax and welfare policies unchanged in nominal terms. This is an unrealistic position, as it would imply a drop in the real value of welfare payments and an increase in the effective tax rate. An alternative is to index welfare and tax in line with inflation, representing a 'no policy change' position as government expenditure remains constant in real terms. However, this would imply that those on welfare would suffer a decline in their living standards relative to those in employment, due to wages rising ahead of inflation. While a reasonable position in terms of ensuring the position of those on low incomes is improved in real terms, it is clearly inadequate if the goal is to equally share the benefits of economic growth. A different policy benchmark is therefore required, one that indexes welfare payments with wage growth in the economy.

In a significant (if unheralded) policy departure, the principle of wage indexation was accepted by government in Budget 2001.<sup>12</sup> It is reasonable to assume that Budget 2002 will retain this policy approach. A similar wage indexation of taxation policy is logical to avoid generating problems relating to work incentives. In overall terms, a wage indexation benchmark would ensure that growth in disposable income is the same for all sectors of the population. In macro-economic terms, indexation to wage growth would represent a broadly neutral budgetary stance, as it would keep government revenue and expenditure roughly constant as a proportion of national income and the Budget surplus (or deficit) would be unchanged from year to year.<sup>13</sup>

Gross wages in 2001 are estimated to be growing by 10.8%, which represents 6% real improvement allowing for inflation (4.8%).<sup>14</sup> Indexation of tax and welfare policies by this amount costs £1,195.8m (tax is £659.4m and welfare £536.4m). This results in an increase in the basic welfare payment from £84 to £93.10 (+£9.10) and from £95.50 to £105.80 (+£10.30) for the non-contributory old age pension. On the tax side, the personal allowance goes up from £5,500 to £6,094 (+£594 or £11.42 per week) and the PAYE allowance from £2,000 to £2,216 (+£216 or £4.15 per week).

Wage indexation would also meet a number of key policy targets for the government:

- £100 for old age pensions by 2002;
- £92 for lowest welfare rates, in order to achieve £100 by 2003;
- increase to 87 per cent the proportion of the minimum wage outside the tax net.

<sup>11</sup> Eurostat (2001), *op cit*

<sup>12</sup> '(welfare) increases are explicitly designed to keep pace with increases in average earnings, not just inflation', Dermot Ahern TD, Minister for Social, Community and Family Affairs, *Irish Times*, 12/1/2001

<sup>13</sup> This fiscal policy stance is the basis of the ESRI *Medium-Term Review 2001-2007*.

<sup>14</sup> D McCoy et al (2001), *Quarterly Economic Commentary*, July 2001, Dublin: ESRI

It should be noted that tax/welfare changes will commence at the start of 2002. This represents a one-off windfall of 2.9 per cent for welfare recipients and taxpayers.

### 3.2 *Targeting of additional resources*

We have already seen that a wage indexed budgetary policy will cost £1,200m to implement. What additional resources might be available to spend on top of this figure and what might be the likely allocation of such additional resources between tax and welfare measures? Recent Budgets have reflected a dramatic increase in resources for tax and welfare changes, rising to £2 billion in last year's Budget. This increased allocation reflects the improved government finances arising from the recent period of sustained economic growth. Earlier forecasts suggested a modest decline in growth to 7 per cent of GNP in 2001, with employment growth of 3.6 per cent or 59,300 more people at work.<sup>15</sup> However, current indications are that these estimates are overly optimistic and a more rapid slowdown is now expected. The weakening economic performance will be reflected in the exchequer finances. Another factor is the high rate of government expenditure, which is 24 per cent up on last year. As a result, it is likely that there will be a minimum £1.5 billion drop in the forecast exchequer surplus of £2.5 billion. A positive feature is inflation, which continues to fall and is now forecast to be less than 5 per cent for the year.

What are the implications of these various factors on the resource package available in Budget 2002? It is likely that the resource allocation for Budget 2002 will be less than 2001, probably of the order of £1.5 billion (as compared to £2 billion last year).<sup>16</sup> This would allow for an expenditure of £300m in excess of wage indexation. A related issue is the likely tax/welfare division of these resources. The division between tax and welfare is crucial in determining the distributive structure of the Budget. Table 1 shows how the additional resources allocated in recent Budgets were shared out between tax and welfare. This differentiates between the amount required for wage indexation and for additional 'discretionary' allocation. The latter figure has varied from £378m to £958m over three Budgets, giving a cumulative total of £2,180m - a considerable package of money. However, the vast bulk of these 'discretionary' resources was allocated to tax reductions, being almost 100 per cent in the earlier Budgets and falling to 78 per cent last year. The increased welfare spend in Budget 2001 can be attributed to the unprecedented increase in child benefit, at a cost of c£250m after indexation. Also, as child benefit goes to all families, it has a similar impact as a tax reduction for better-off households. In all, 89 per cent of additional resources (£1,942m) in the last three Budgets was allocated to tax reductions.

**Table 1: Allocation of resources in Budgets 1999-2001**

<b><i>Year</i></b>	<b><i>Allocation (£)</i></b>	<b><i>Indexation cost (£)</i></b>	<b><i>Additional resources (£)</i></b>	<b><i>Tax share of additional resources (£)</i></b>
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<sup>15</sup> D McCoy et al (2001), *op cit*

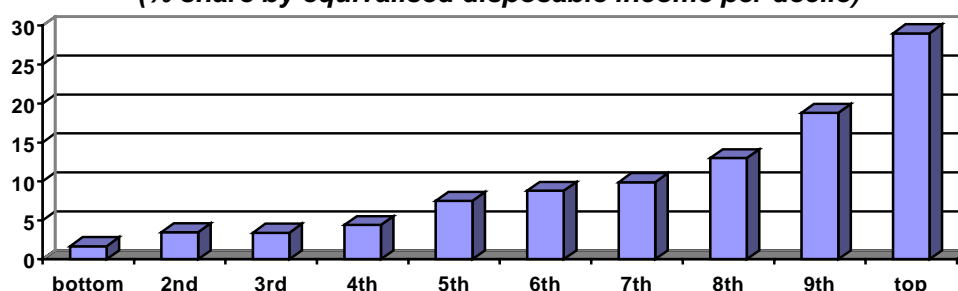
<sup>16</sup> This amount could be further restricted if the government decides to further increase public expenditure, eg on health, in Budget 2002.



1999	831	453	378	370 (98%)
2000	1540	696	844	827 (98%)
2001	2068	1110	958	745 (78%)
Total	4439	2259	2180	1942 (89%)

This prioritisation of tax reductions is reflected in the distribution of the additional resources (above wage indexation) in recent Budgets. Diagram 3 outlines the distribution of the £1 billion aggregate 'gain' in Budget 2001.<sup>17</sup> By far the biggest share of resources - 29 per cent - went to the richest 10 per cent of the population. By contrast, the poorest 10 decile received less than 2 per cent of the total, a share ratio of 1:14.5 between the bottom and the top. In all, the richest 30 per cent received over half of all resources (60 per cent), while the poorest three deciles less than 10 percent. It is clear that prioritising tax reductions targets Budget gains on the better-off.

**Diagram 3: Distribution of total resources in Budget 2001  
against 2000 policy indexed to wages  
(% share by equivalised disposable income per decile)**



The effect of this policy on disposable income can also be examined. Analysis of recent Budgets shows that average incomes grew by over 7 per cent compared to a wage indexed benchmark.<sup>18</sup> The level of increase, however, is very uneven between income groups. Poorer households saw very modest improvements in living standards over wage indexation of less than 3 per cent. By contrast, those on middle and higher incomes received gains of up to 9 per cent. This skewed distribution has contributed to the maintenance of high rates of relative income poverty.<sup>19</sup> As the 1999/2000 report of the inter-departmental policy committee notes, Budget-induced widening of income inequalities threatens to undermine the NAPS objective of reducing poverty.<sup>20</sup> It is clear from this analysis that a fiscal strategy with poverty as its central theme should allocate a greater share of discretionary resources on

<sup>17</sup> SWITCH analysis undertaken by the Combat Poverty Agency

<sup>18</sup> T Callan et al (1999), 'Income tax and social welfare policies', in C Kearney (ed), *Budget Perspectives*, Dublin: ESRI; T Callan and B Nolan, *The Irish Times*, December 1999; Combat Poverty Agency (2001), *Analysis of Budget 2001*, Supplement to *Poverty Today*, No 50.

<sup>19</sup> Under Budget 2001, there were slight falls of 0.3 per cent and 0.2 per cent at the 40 and 60 per cent poverty lines and an increase of 0.1 per cent at the 50 per cent line. The poverty gap was unchanged.

<sup>20</sup> *Social inclusion strategy: 1999/2000 annual report of the Interdepartmental Policy Committee*, p64.

welfare expenditure and not tax. This welfare-first approach is the basis of the strategy which informs the Agency's policy proposals for Budget 2002, which are now outlined.

#### **4. Budget priority 1: higher welfare payments**

The adequacy of welfare payments has re-emerged as a key policy concern in the light of recent improvements in general living standards. The importance of an adequate welfare payment in tackling poverty is recognised in national and EU policy. The adequacy of welfare payments was recently considered by the social partners (social welfare benchmarking and indexation working group).<sup>21</sup> The majority view of the group was to recommend a minimum adequacy target of 27 per cent of gross average industrial earnings (GAIE), to be achieved in Budget 2006 (the estimated current year equivalent of £101. A higher target was also considered: 30 per cent GAIE (estimated equivalent of £112.50). The Agency considers that the £101 figure is a rather modest target, given the existing government commitment to a target of £100 by 2003 and that the wage-indexed rate will be £93.10 in 2002. We therefore propose that this figure (and its underlying rationale: 27 per cent of GAIE) be considered an interim target, to be reached over the next three Budgets. In that context, the Agency recommends that the lowest welfare payment be increased by a further £4.90 (on top of wage indexation) to give a minimum weekly payment of £98. Other payments would be also raised to this minimum floor, thereby reducing the differential between welfare categories. The full year cost of this would be £58.8m, which is clearly affordable. A parallel increase in tax allowances might be required to minimise possible disincentive effects of this higher welfare payment (see section 6 below).

A related adequacy issue concerns the additional welfare payment provided for couples. The adequacy of this payment (the qualified adult allowance) is not calculated separately, but is based on a proportionate amount of the personal rates. In recent years, this has been in the region of 60 per cent. A recent review of these equivalence scales has shown that the additional payment for couples is too low to ensure comparable living standards.<sup>22</sup> The Agency proposes that the qualified adult payment should be increased to 70 per cent of the reformed lowest personal rate (£98), giving a revised payment of £68.60. Again, this would act as a floor for all qualified adult payments. The cost of this is £24m.

#### **5. Policy priority 2: increased level of child income support**

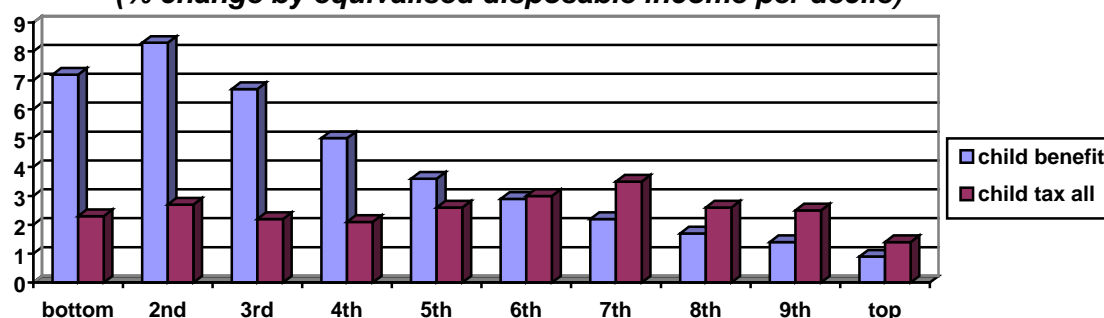
The welfare of children is a priority concern of the Agency. Our high child poverty rates demand a targeted policy response centred on an enhanced system of child income support. There are two main concerns here: the level of child support and the method of delivering this support. Budget 2001 marked a watershed by introducing a three-year programme to treble child benefit. Budget 2002 should continue this by giving a further increase of £25 per month, representing an increase of 37 per cent. The cost of this is £332.9m, though this falls to £229.3 after allowing for indexation in line with wages, which costs £93.6m. The result will be a monthly child benefit of £92.50 (£111 higher rate) or £21.35 per week (£25.62 higher rate). The increase when measured by the wage-indexation benchmark is less than that at £18 per month or £4.15 per week, an increase of 24 per cent.

<sup>21</sup> *Final report of the social benchmarking and indexation group* (2001)

<sup>22</sup> *Report of the working group examining the treatment of married, cohabiting and one-parent families under the tax and social welfare codes* (1999), Dublin: Stationery Office

Underlying the child benefit increase is a policy concern to provide an equitable system of support with childcare costs. The choice of child benefit as the means to deliver this support has not met with universal approval, with a number of groups supporting a dedicated childcare payment, ranging from a tax allowance or a taxable cash payment. The Agency strongly supports the child benefit route as being the fairest way of meeting the direct and indirect costs of children, with a particular gain for families on the lowest incomes. This is emphasised by a distributive analysis of the increased child benefit in Budget 2001 as compared to an alternative childcare tax allowance/child benefit policy mix (diagram 2).<sup>23</sup>

**Diagram 4: Average gain from from child benefit increase in Budget 2001 vs alternative childcare tax/child benefit package (% change by equivalised disposable income per decile)**



The greatest percentage gains under the child benefit increase go to households on the lowest incomes: between 7 and 8 per cent. The percentage gain decreases as income rises, with the most affluent groups gaining less than 2 per cent. By contrast, an alternative tax-based child income package would give roughly similar percentage improvements for all deciles and therefore is far less targeted. Childcare tax relief, even when combined with child benefit, clearly favours families at the upper end of the income schedule. On this basis, the Agency reiterates its opposition to the introduction of a tax-based childcare payment. However, it does acknowledge the need to provide further investment in the supply of social and affordable childcare.

Even allowing for the child benefit increase, there remains a major concern as to the adequacy of child payments for those on welfare. In the first instance, part of the gain from the child benefit increase will be lost for welfare families if government persists with its recent policy of freezing of child dependant allowances. Thus, the real gain for children in poor families is £2.68 per week when benchmarked to wages.

Second, the combined rate of child income support, including the proposed child benefit increase, of £35.76 is not based on an objective measure of adequacy.<sup>24</sup> The adequacy of child payments was considered by the social welfare benchmarking and indexation group. The group did not calculate what an adequate payment would be, but reviewed research on child equivalence scales. The group proposed that payments for children should be based on an equivalence scale of 33 to 35 per cent of the personal rate. In terms of our earlier proposal for a minimum welfare payment of £98, the equivalent child payment would be between £32 and £34. This cannot be

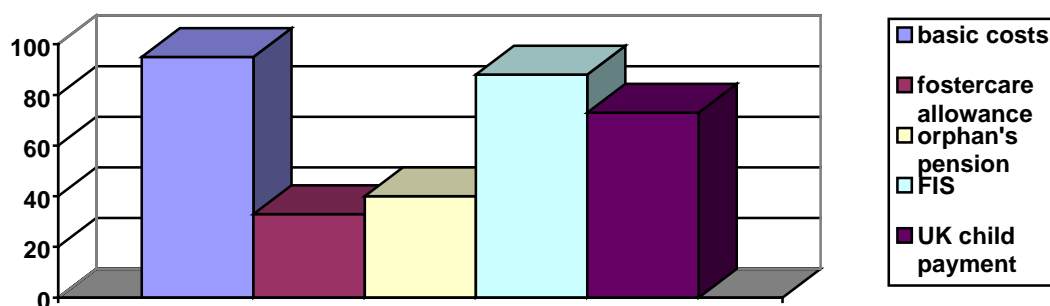
<sup>23</sup> £4,000 purchased childcare tax allowance and child benefit increase of £2 per week.

<sup>24</sup> Made up of 21.35 child benefit, £13.20 child dependant allowance and £1.21 clothing and footwear allowance.

considered a significant proposal when compared with the proposed combined value of child income support post-Budget 2002 of £35.76.

The post-Budget 2002 minimum rate of child income support can be compared with alternative measures of the costs of a child, eg basic costs, fostercare allowance, orphan's pension, family income supplement and UK welfare rate for children. The 2002 minimum rate of child income support would represent 95 per cent of the basic costs of a child (£38.20, based on original estimates carried out in 1992 and increased by inflation).<sup>25</sup> The minimum child welfare payment is 33 per cent of the combined fostercare allowance/child benefit (£89.01 + £35.76). It is 40 per cent of the (uprated) orphan's allowance (£70.50) + child benefit. It is 88 per cent of the average FIS payment (£20) + child benefit. Finally, it would constitute 89 per cent of the UK rate.

**Diagram 5: Reformed child income support as a proportion of various measures**



On this basis, the Agency believes that welfare payments for children will still be inadequate to meet basic child-rearing costs even with the proposed child benefit increase. A further increase in child income support is therefore proposed for Budget 2002. How might this be delivered? Two options present themselves: an increase in the lower rates of child dependant allowance (£13.20 and £15.20) or a further increase in child benefit. Child dependent allowances are the most targeted way of delivering additional resources to poor children. This option is problematic, however, in that government policy has frozen child dependant allowances since 1993 for fear of exacerbating work disincentives. Given the tight labour market and the fundamental shift in the structure of child income support, there is scope to at least rationalise the existing three tier payments into one, equivalent to the highest rate (ie £17). A further increase in child benefit, while in line with government policy, is rather costly (an additional £1 per week would cost £58m). One option to curtail costs would be to focus resources on the higher rate of child benefit (based on the rationale that larger families have a higher poverty risk). The Agency proposes the following:

- Bring the lowest child dependent payment up from £13.20 to £15.20 (the current middle rate), as part of a two-year strategy to equalise all payments at £17;
- Increase the reformed higher child benefit to £30 per week (£130 per month), the equivalent of an additional £4.38 per week (£19 per month)

<sup>25</sup> C Carney et al (1994), *The cost of a child. A report on the financial costs of child-rearing in Ireland*, Dublin: Combat Poverty Agency.

- Extend child dependent allowances to children aged up to 22 years in full-time education (a commitment in the Programme for Prosperity and Fairness).

The cost of these reforms is £54.5m ( £11.5m for child dependant allowances and £43m for child benefit; no costing is available for the age extension of child dependant allowances). However, the Agency has assumed savings of £21m from the non-indexation of child dependant allowances, giving a net cost of £33.5m. With the further increases in child benefit, it is proposed that the payment would be made on more frequent basis (fortnightly or weekly). Also, the commencement date for the new rates should progressively be brought forward to the start of the year.

## **6. Policy priority 3: reform of personal taxation**

The total cost of the Agency budgetary package is £1,481.9m. This is likely to exhaust the amount of resources available in the Budget in the current economic climate. This would not allow any further tax reductions beyond indexation. This can be justified on grounds of the massive scale of resources allocated to tax cuts in recent Budgets above wage indexation (almost £2,000m), which has conferred a major income boost to better-off households. Furthermore, this allocation to tax reductions has been at the expense of welfare expenditures. Second, tax reductions, even of the most progressive kind, confer no direct benefit to those on the lowest incomes. Indeed, the greatest share of tax resources goes to the richest households. A shift in policy priorities from tax to welfare is justified if reducing poverty is to be the focus of Budget 2002. Finally, recent tax cuts have left Ireland with the lowest tax take as a proportion of GNP in the EU, which limits fiscal policy options in future years.

However, the Agency acknowledges the commitment under the Programme for Prosperity and Fairness to remove those earning the minimum wage from the tax net. This would require a further increase in personal/PAYE allowances beyond that already proposed through indexation. How might this then be funded, given that there are no additional resources available? One option is to make any additional increases conditional on compensatory changes in other aspects of the tax system. This could be achieved by abolishing the threshold for employee's PRSI, a logical move in light of the abolition of the employer ceiling in Budget 2001. This ceiling has a regressive effect, with higher earners paying a smaller percentage of their income on PRSI. It should also be taken into account that the PRSI rate has fallen in recent years from 5.5 per cent to 4 per cent. Abolishing the ceiling would bring PRSI in line with the flat rate structure of the health levy. This reform would yield £108m. The Agency therefore proposes to increase the PAYE allowance by a further £334 on top of wage indexation (£2,550). The cost of this is £74.5m, resulting in a net saving of £30.6m. This would leave 91 per cent of the minimum wage exempt from tax.

## **7. Budget outcome**

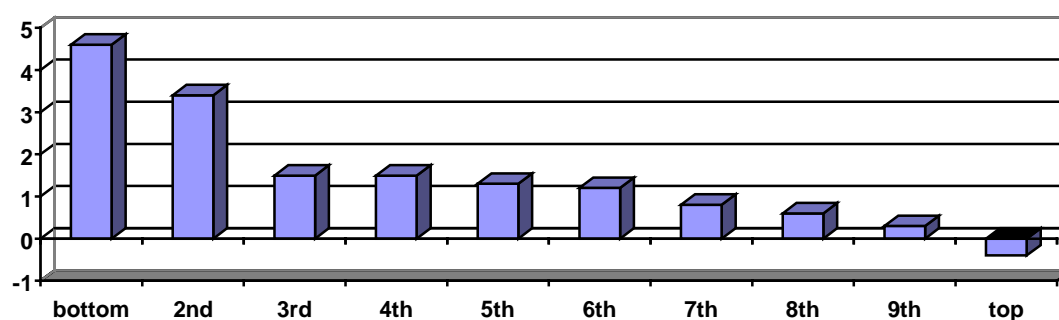
Table 2 presents a summary of the main Agency recommended measures in Budget 2002. The total budget package costs £1,481.9m, of which four-fifths is accounted for by wage indexation (£1,195.8m). The remaining resources are all allocated to welfare measures, plus a small clawback of resources on the tax side. However, the main proportion of this welfare expenditure is devoted to child benefit, which goes to families across the income schedule. In overall terms, 42 per cent of the Budget allocation goes on tax reductions, with the remaining 58 per cent for welfare.

***Table 2: Summary cost of Agency recommended measures in Budget 2002***

<b>Measure</b>	<b>Welfare (£m)</b>	<b>Tax (£m)</b>
Indexation in line with wages (10.8%)	536.4	659.4
Freeze on CDAs	(21)	
Child benefit +£25	245.1	
Top-up of £4.90 in basic welfare rate	58.8	
Qualified adult allowance to 70% of personal rate	24	
Lowest CDA rate increased by £2	11.5	
Additional £19 on higher CB rate	43	
Extension of CDA to 22 year olds	n/a	
Employee PRSI ceiling abolished		(108)
PAYE allowance increased by £334		77.4
<b>Total</b>	<b>853.1</b>	<b>628.8</b>

The redistributive outcome of the Agency's Budget 2002 proposals is outlined in the diagram 6. This is assessed against Budget 2001 policy indexed by wages. The average gain in disposable income is projected to be just under 1 per cent. The highest percentage gains go to the two lowest income deciles: between 3.5 and 4.5 per cent. The third to sixth deciles gain significantly less, but still above the average (1 and 1.5 per cent). The incomes of the richest households improve least, with the wealthiest decile actually recording a slight drop in income relative our benchmark. This is a major reversal of the pattern achieved in recent Budgets. There is also a much fairer allocation of aggregate resources: 32 per cent goes to the bottom fifth, while the richest 20 per cent lose £27 million.

**Diagram 6: Distributive impact of Agency-proposed Budget 2002  
against 2001 policy indexed to wages  
(% change by equivalised disposable income per decile)**



We can also consider the impact of the proposed Budget on relative income poverty. Table 3 sets out the income poverty rate and poverty gap (a more sophisticated measure which takes into account the depth and distribution of poverty) as compared to a wage-indexed Budget. This table shows a reduction in relative poverty of between 0.6 and 1 per cent. This is an extremely significant outcome given the stability of recent poverty trends. Also, the poverty gap reduces, indicating that the fall in poverty is not simply dependant on the location of the poverty line.

**Table 3: Impact on relative income poverty and income poverty gap of Agency-proposed Budget 2002 against 2001 policy indexed by wages<sup>26</sup>**

<b>Poverty line</b>	<b>Head count</b>		<b>Poverty gap</b>	
	Budget 2002 Change		Budget 2002 Change	
40%	9.58%	-	1.47%	-
	0.70%		0.32%	
50%	20.29%	-	4.21%	-
	0.61%		0.40%	
60%	26.86%	-	7.40%	-
	1.03%		0.41%	

Consideration can also be given to the effect of the proposed changes on work incentives, especially because of the link between unemployment and poverty. The initial indexation of tax and welfare in line with wages will ensure that relativities are maintained. The shift to universal child benefit as a means of supporting families, along with the general freeze on child dependant allowances, should have a positive effect as child benefit will now represent a higher proportion of the child income support package for those on welfare. The increase in the adult and couple payments can be seen as having a potentially negative effect. However, this will be off-set by the increase in PAYE allowances. Also, the increase in the minimum wage from £4.70 to £5 in 2002 will enhance the reward from low-paid work.

### **Other policy measures**

#### **8.1 Savings scheme for low-income households<sup>27</sup>**

The government introduced a special savings incentive scheme in Budget 2001. Savings are of particular importance to low-income households: they provide a financial cushion to cope with unexpected costs or a drop in income and make it easier to access reasonably priced credit. However, this scheme as currently designed is of limited benefit for low-income households as:

- the minimum savings required is too high;
- the duration of the scheme is too long;
- the incentive provided is too low.

In addition, the marketing of the scheme by financial institutions frequently excludes smaller savers, eg by having a much higher minimum payment than is legally required. Participation is also hindered by the ban on the use of savings to access

<sup>26</sup> The average weekly household equivalent income under the index 2001 policy is £280.15 and £288.40 under the proposed Budget 2002. The cash equivalent for the various poverty lines under Budget 2002 is £115.36 (40%), £144.26 (50%) and £173.04 (60%).

<sup>27</sup> This proposal is similar to that proposed by the National Advisory Committee for the Money Advice and Budgeting Service, on which the Agency is represented.

credit and the large numbers of low-income households who are not part of the mainstream financial system. As a result, the likely take-up of the scheme among low-income households will be low.

From an equity viewpoint, the scheme is also problematic in that the greatest benefits will be conferred on better-off households, who by definition can save more. The Agency estimates that a third of the government gains under the scheme will go to the richest 20% of the population, as compared to 4 per cent for the poorest fifth. The Agency therefore recommends the introduction of a complimentary savings scheme targeted at low-income households, with the twin aims of increasing take-up and distributing government resources more fairly. It would have the following elements:

- a **savings** requirement of up to £2.50 per week over a 26 week period
- a **top up** of £1 for every pound saved, to a maximum amount of £240
- provision to use the savings to access **credit**.

The proposed scheme targets the segment of the population currently excluded by the £10 threshold. The higher subsidy can be justified on incentive and equity grounds. Any possible displacement effect on the existing scheme is limited by the capping of the maximum benefit at £240 (equivalent to what a person saving £16 per month under the existing scheme would receive). The credit facility will be an attractive feature for those who otherwise would not have access to small-scale loans and as such, will not contribute to inflationary pressures.

The scheme should be promoted in conjunction with the Money Advice and Budgeting Service, as it would support its work by:

- reducing the risk of indebtedness;
- promoting thrift and financial management;
- providing an affordable credit alternative to moneylenders;
- facilitating access to financial services among the 'unbanked'.

The cost of the targeted scheme is estimated to be £60 million over three years.<sup>28</sup> This can be set against an estimated cost of £1,000 million of the existing scheme, almost 17 times more. Furthermore, the targeted scheme would increase by 150% the estimated gain to low-income households under the current scheme (£40m).<sup>29</sup>

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<sup>28</sup> This is calculated as follows:

eligible adults:	1,000,000 (number of welfare recipients/adult dependants)
50% take-up:	500,000
maximum gain:	£240
average gain:	£120
cost:	£60 million (ie £120 x 500,000)

<sup>29</sup> Combat Poverty Agency (2001), *Analysis of Budget 2001*, Supplement to *Poverty Today*, March/April 2001, No 50.