

Improving the incomes and opportunities of welfare recipients and the low paid

PRE-BUDGET SUBMISSION

Combat Poverty's submission on Budget 2005 addresses the growing number of low-income households in Irish society. Rising average incomes have not benefited everyone to the same extent, with a growing proportion of the population (22 per cent) below 60 per cent of median income, the EU measure of relative income poverty. The group most affected is households dependent on social welfare, who now have a one-in-two risk of poverty. At the same time, low-paid families represent an increased share of poor households. Clearly employment policies must be supplemented by tax and welfare measures which boost the incomes of those on welfare and in low-paid work.

Budget 2005 presents an opportunity to intensify the redistributive approach in the last two budgets, based on the additional resources now becoming available. In this context, Combat Poverty proposes an affordable tax and welfare package of €1,200 million, which is €280 million more than Budget 2004 and €366 million ahead of a wage-indexed budget. Of this, 54 per cent (€665 million) goes on welfare improvements, 20 per cent (€239 million) on universal child benefit and €305 million (26 per cent) on tax reductions. If the Government decides to spend more on tax and welfare measures in the Budget, the pro-welfare emphasis should be retained over additional tax cuts.

Summary of recommendations for Budget 2005

| Policy issue | Proposals | Cost (€m) |
|------------------------------------|--|-----------|
| Welfare payments and supports | Increase personal rates by €12 per week (9%) | 569 |
| | Increase qualified adult allowances by €9 per week (10 %) | 55 |
| | Introduce a pilot savings incentive scheme for indebted households in conjunction with the Money Advice and Budgeting Services | 1 |
| | Reform means-tests and income disregards for welfare schemes | 20 |
| Child income support | Increase child benefit by €17.60 per month (€20.10 for the higher rate) (13% and 12% respectively) | 239 |
| | Make the clothing/footwear allowance an automatic entitlement for recipients of means-tested CDAs | N/A |
| | Enhance provision of school breakfasts and lunches | N/A |
| Low-wage working families | Increase threshold for family income supplement by €35 per week (9%) | 12 |
| | Increase PAYE tax credit by €240 per annum (23%) | 305 |
| | Increase medical card threshold for children by €14 per week (€22 for larger families) | N/A |
| Early childhood education and care | Increase the affordability of early years care for low-income families through direct subvention to accredited childcare providers | N/A |
| | Ensure morning pre-school provision for all poor children aged 4 years, supplemented by all-day care where appropriate | N/A |
| | Provide trained child assistants in all infant classes, prioritising disadvantaged schools in the first instance. | N/A |

The challenge of relative income poverty

Average incomes have risen significantly in the last decade due to a combination of higher wages, tax reductions and more employment, leading to a fall in consistent poverty.¹ However, EU poverty measures based on relative income highlight continuing challenges in tackling poverty in Ireland. These indicate that 22 per cent of the population were below the poverty threshold of 60 per cent of median income in 2001, up from 16 per cent in 1994. Furthermore, the depth of relative income poverty has risen substantially since 1994, indicating a significant polarisation in income distribution between poor and non-poor households.

The persistence of relative income poverty has also worsened, from 10 per cent of the population in 1997 to 16 per cent in 2001. As this increase is ahead of the growth in the annual poverty rate, it means that a higher proportion of those in relative income poverty in 2001 have experienced long-term poverty, with 'all the attendant implications this has for financial strain, psychological distress and physical health'.²

These trends – more people on relatively lower incomes for a longer period of time – pose a major challenge for Government policy on poverty. This is further underlined when Ireland's poverty rate is compared with other EU countries. The most recent figures, which relate to 1999, indicate that Ireland has a poverty rate 20 per cent higher than the EU norm. Ireland also has a higher rate of persistent income poverty, which is a third more than the EU average. In the context of the EU Lisbon goal of making a decisive impact on poverty by 2010, there is a significant amount of ground to make up to bring Ireland into line with European best practice.

The deteriorating position of households on welfare and low pay

Underpinning the rise in relative income poverty are significant changes in the households at risk of poverty. Increasingly, those at high risk are not in the labour force due to retirement, illness or engagement in home duties. The deteriorating position is especially stark for welfare recipients, who face risks of income poverty of between 40 and 50 per cent. Furthermore, welfare-dependent households – across all categories – now account for three-quarters of those in income poverty.

Poverty risk for recipients of welfare payment

| | 1994 | 2001 | change |
|---------------------------------|------|------|--------|
| Old age pension | 5.3% | 49% | +46% |
| Unemployment benefit/assistance | 24% | 43% | +19% |
| Illness/disability | 10% | 49% | +39% |
| Lone parent's allowance | 26% | 40% | +14% |
| Widow's pension | 5% | 42% | +37% |

This deterioration arises because welfare payments, though increasing in real terms in recent years, have lagged behind average income growth. The social welfare system thus leaves a large percentage of the population below the 60 per cent income threshold. Increasing payment levels, along with improve access to other income sources, are the key levers through which the position of welfare recipients can be improved. This is also the conclusion of a recent comparative study of income poverty in Ireland, with EU best practice in achieving low poverty rates requiring a more comprehensive safety net and higher welfare payments than is currently the case in Ireland.³

Another contributor to the high rate of income poverty is low-paid employment. Households headed by someone in low-paid work now account for 17 per cent of people below 60 per cent of median income. This mainly reflects the higher number of low-paid employees in the labour force.

Furthermore, 35 per cent of poor children now live in employed households, a fourfold increase since 1994. This highlights the need to boost the incomes of families relying on low-paid earners.

Budgetary strategy

Combat Poverty's strategy for Budget 2005 is shaped by a number of considerations. First, it is important that the redistributive focus of recent budgets is maintained. The key factors shaping this impact were the overall prioritisation of welfare measures over tax reductions (68 per cent compared to 32 per cent in Budget 2004) and, more particularly, the substantial increase afforded to welfare recipients (€10 in 2004). The disappointing element of recent budgets was the modest increase in child income support. Our proposals for Budget

¹ Consistent poverty means being on a low income and deprived of basic necessities.

² Christopher Whelan et al, 2003, *Monitoring Poverty Trends in Ireland: Results from the 2001 Living in Ireland Survey*. Policy Research Series Number 51. Dublin: ESRI

³ Tim Callan et al (2004), *Why is Relative Income Poverty so High in Ireland?*, Policy Research Series Number 55, Dublin: ESRI

2005 maintain this pro-welfare approach, especially as additional resources become available.

Second, recent revenue returns indicate a market improvement in the public finances, with tax revenues up by 15 per cent, while expenditure is slightly lower than expected. Part of the higher revenue is attributed to once-off factors, but the underlying trend in tax receipts is ahead of forecast. The Exchequer is currently on track to record a lower than expected deficit of €1 billion (less than 1 per cent of GDP). On this basis, an increased allocation for tax and welfare measures in Budget 2005 is a realistic expectation.

In this submission, a tax and welfare allocation of €1,200 million is proposed, which is €280 million more than allocated in 2004 and €366 million ahead of a wage indexed budget. Additional resources could be provided for targeted social expenditure of circa €100 million.

Third, key Government policy targets on welfare are:

- €171 per week (forecast 2007 values) for minimum welfare payment
- €200 per week for old age pension
- €149 per month for child benefit.

Delivering these commitments rather than tax reductions should be the policy priority.

Fourth, there should be further reform of the tax system, especially in regard to broadening the tax base. It is regrettable therefore that the Government has decided not to introduce a carbon tax. This potential source of tax revenue (up to €365 million yearly) would have enabled the Government to fund an extensive programme to tackle fuel poverty, including heating efficiency measures and targeted income supports.⁴

Discretionary tax expenditures contract the tax base and introduce inequities. Removing these can generate more resources, while making the tax system fairer. Official papers suggest the loss to the Exchequer of tax expenditures is over €7 billion per annum. Among the options to be considered in reducing tax expenditures are to end reliefs which

are of questionable economic value and to curtail the value of tax reliefs. The latter could be achieved by standard-rating all personal tax reliefs, along with setting a minimum effective tax rate for earners above a certain income threshold.⁵

Finally, the policy approach to indirect taxes and user charges should be reconsidered. These revenue instruments tend to be regressive, in that low-income households are worst affected. One example of this is waste collection charges, which have increased significantly in recent years. At the same time, there is no system for moderating these charges for low-income households, although such a system does exist for taxpayers.

Policy priorities for Budget 2005

The four policy priorities in the submission are welfare payments and supports, child income support, low-paid working families and early childhood education and care.

1. Welfare payments and supports

The Government policy target is a basic welfare payment of €150 by 2007, which is the equivalent of €171 adjusted by forecast inflation.⁶ This leaves a gap of €36 to be made up in the remaining three budgets. This requires an enhancement of the flat rate welfare increase in Budget 2004, with a minimum increase of €12 per week recommended in the personal rate in Budget 2005.

The additional payment for spouses or partners is important in determining the living standards of couples. Currently, an additional adult receives 66 per cent of the personal rate, on the basis of economies of scale where two adults live together. An official review of equivalence scales has indicated that the additional payment for a second adult is too low to ensure comparable living standards with single adult households.⁷ In line with this finding, the government agreed in Budget 2000 to increase the qualified adult allowance to 70 per cent of the personal rate. A flat rate increase of €9 per week in the qualified rate would increase its equivalence value to 67 per cent for the lowest welfare categories.

As well as increases in basic payments, Combat Poverty recognises the need to reform the welfare system to encourage employment and promote

4 See Combat Poverty Agency submission on a carbon tax, October 2003.

5 A recent Revenue Commissioners survey of high earners reveals that 18 per cent pay an effective tax rates of less than 20 per cent, the equivalent of the standard rate of income tax. Indeed, a small minority (7 per cent) pay no income tax at all, while a similar number pay less than 10 per cent.

6 Combat Poverty acknowledges there are other interpretations of how this target might be adjusted in 2007 values, based on indexation by wages or the equivalent of 30 per cent of gross average industrial earnings.

7 *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

financial independence. Anomalies and disincentives are part and parcel of a means-tested and categorical social welfare system. Combat Poverty supports ongoing efforts to broaden eligibility to the various categorical welfare schemes, such as the Carer's Allowance. In addition, Combat Poverty supports changes in income disregards which encourage rather than penalize welfare beneficiaries who seek to take up employment on a part-time or casual basis.

The submission highlights the role of savings in assisting financial independence. The main policy measure for savings, the special savings incentive scheme or SSIA, is of minimal benefit to low-income households because of its minimum savings requirement and other features. By contrast, the UK government has introduced a Savings Gateway pilot project to encourage low-income households to save as part of a community financial and learning initiative. An interim evaluation of the scheme shows that the scheme is a success in encouraging this target group to save regularly.⁸

The Money Advice and Budgeting Service (MABS) is the lead agency on financial management in low-income households. Combat Poverty supports the proposal of the MABS national advisory committee to encourage savings among indebted clients, with the aim of aiding their transition to financial independence. The proposed two-year pilot scheme has the following components:

- a savings requirement of €1 to €5 per week or €5 to €25 per month
- a Government top up of €1 for every €1 saved, to a maximum of €600
- a minimum savings period of 6 months required to retain the top-up.

As well as encouraging savings, the scheme would facilitate access to financial services for excluded groups, eg access to a low cost current account, use of electronic benefit transfer.

Key Proposals

- *Increase all personal rates by a minimum of €12 per week*
- *Increase the qualified adult allowance by €9 per week*
- *Encourage take-up of employment and savings among welfare recipients (€21 million)*

2. Child income support

Government policy has prioritized Child Benefit as the route for channelling resources to families, including those on low incomes. Child Benefit now fulfils a number of policy aims such as promoting horizontal equity, assisting families with childcare costs, tackling child poverty, supporting low-paid families and giving an independent income to child carers in the home. To fulfil this comprehensive mandate, the Government has set a Child Benefit target of €149 per month by 2005 (equivalent of €34.40 per week).

Combat Poverty supports this universal approach to child income support as it confers the greatest proportional gain on poorer families and minimizes work disincentive effects. However, progress towards the target figure has been slow in the last two budgets. To maintain public support for the Child Benefit approach, the outstanding increase of €17.60 should be provided in Budget 2005. As the main blockage in achieving this has been the competing pressures on the welfare budget envelope, the cost of the Child Benefit increase should be provided for separately from the welfare allocation. This approach can be justified in that Child Benefit goes to taxpayers as well as welfare recipients.

Targeted child income supports will continue to have a key role in ensuring an adequate payment for welfare-dependent children, especially the older child. Improvements in these supports have been deferred pending the completion of a review by NESC, as part of the Special Initiative on Ending Child Poverty. Despite this, there is a number of education-related welfare supports which, if enhanced, could have a significant impact on the school participation of poor children. These pertain to the take-up of the Back-to-School Clothing and Footwear Scheme, which should be integrated into the mainline welfare system, and the quality and quantity of the school meals scheme, which, if improved, could provide multi-faceted benefits for the health and education of poor children.⁹

Key Proposals

- *Increase Child Benefit by €17.60 per month, with a €20.10 increase in the higher rate*
- *Pay the Clothing/Footwear Allowance to all means-tested Child Dependent Allowance recipients*
- *Further expand the provision of school breakfasts and hot lunches*

8 Elaine Kempson et al (2003), *Evaluation of the CFLI and Saving Gateway Pilot Projects. Interim report on the Saving Gateway pilot project.* Personal Finance Research Centre, University of Bristol.

9 Combat Poverty Agency (2000), *Submission to the Department of Social, Community and Family Affairs on its evaluation of the school meals scheme.* These proposals are also in line with the review of school meals schemes published by the Department of Social and Family Affairs in 2003.

3. Welfare to work measures

Combat Poverty recognises the key contribution of paid work if poverty is to be tackled. To make work pay, especially where children are being supported, the main policy instrument is Family Income Supplement, while secondary benefits such as the medical card and rent supplements also play an important role. Family Income Supplement remains an under-used instrument because of take-up problems. However, pending the proposed NESC review, Combat Poverty proposes an increase in the income threshold for the Family Income Supplement to parallel the increase in welfare payments.

On the tax side, the priority is to ensure that the tax burden is reduced for those on low incomes, in particular the minimum wage. The most cost-efficient and targeted way to deliver an increase for low-paid workers is through the PAYE tax credit.¹⁰ An increase of €240 in the PAYE tax credit is therefore recommended at a cost of €305 million.

The medical card is a key instrument for providing access to health and social services for poor children. However, eligibility is restricted by the exceedingly low income thresholds of the scheme, which impacts most on low-paid working families. Combat Poverty supports a significant increase in eligibility thresholds, especially for children, as recommended in a recent review.¹¹

Key Proposals

- *Increase threshold for family income supplement by €35 per week (9 per cent)*
- *Increase PAYE tax credit by €240 per annum (23 per cent)*
- *Increase medical card threshold for children by €14 per week (€22 for larger families)*

4. Early childhood education and care

In addition to welfare measure for tackling child poverty, Combat Poverty highlights the need to enhance social provision for poor children, especially in the early years. The education and care of young children is of dual importance in tackling child poverty: it facilitates parents, especially mothers, to access employment and it gives children a better start in life.

The recent OECD review highlights a number of system failures in provision for early childhood.

There is no coherent policy governing early education and care and no single agency has the lead function. Access is haphazard, with deficiencies in terms of the availability of services and of the financial obstacles to using these services. The quality of provision is uneven, with a lack of quality standards and supports¹². The OECD review makes a number of policy recommendations, three of which are highlighted in this submission as a targeted social investment in poor families.

Key Proposals

- *Increase the affordability of early years care for low-income families through direct subvention to accredited childcare providers*
- *Ensure morning pre-school provision for all poor children aged 4 years, supplemented by all-day care where appropriate*
- *Provide trained child assistants in all infant classes, prioritising disadvantaged schools in the first instance.*

Analysis of distributive impact of Combat Poverty proposals for Budget 2005

It is Government policy that all major policy proposals, such as the annual Budget, are assessed in advance as to their impact on poverty and the inequalities leading to poverty. In line with this approach, the Combat Poverty tax and welfare proposals for Budget 2005 are now assessed as to their distributive and poverty impact using the ESRI tax/welfare model, SWITCH, to take into account variation in individual and family circumstances.¹³

To establish a baseline for assessing budgetary changes, the SWITCH model constructs a comparator budget based on indexation of tax and welfare rates in line with forecast wage growth for 2005 (4.2 per cent).¹⁴ The SWITCH costings are within 5 to 10 per cent of the official figures and have an identical total cost of €1,180 million (the allocation of €20 million for welfare supports is excluded from this).¹⁵ The Combat Poverty proposals cost €366 million more than a wage-indexed alternative. This includes an additional €509 million on welfare increases and child benefit, while there is a shortfall of €143 million on the tax side compared to an indexed budget.

10 Increasing the PRSI allowance is another option. However, there would be no gain from such a measure to workers earning less than the exemption threshold of €287 per week.

11 *Report of the Medical Card Review Group, 2001*. The report recommends a higher income threshold for the fourth and subsequent child. However, in line with the structure of child benefit, Combat Poverty proposes this should be applied to the third-plus child.

12 *OECD Thematic Review of Early Childhood Education and Care Policy in Ireland*. Available at www.oecd.org/edu/earlychildhood.

13 SWITCH is a well-established policy tool for analysing the first round effects of tax and welfare policies, and forms part of the poverty proofing analysis of the Budget produced by the Department of Finance.

14 D McCoy et al, *Quarterly Economic Commentary, Autumn 2004*, Dublin: ESRI

Diagram 1 shows the distributive impact of the Combat Poverty proposals. There is a modest average gain of 0.6 per cent in disposable income. This average gain, however, is highly skewed towards those on the lowest incomes, as the bottom three deciles benefit by an average of 4 per cent. The gain for the fourth to seventh deciles is much smaller at between a half and 1.5 per cent. The position of the top 30 per cent is largely unchanged, with a marginal decline of 0.1 to 0.2 per cent.

In cash terms, the average increase is €3.44 per adult equivalent per week. The gains for those on the lowest deciles are well ahead of this, at between €5 and €11 per week (up to three-times the norm). Middle income groups gain between €2.50 and €6.25 per week. The richest deciles are worse-off by less than €3 a week. In aggregate terms, almost 70 per cent (€250 million) of the total increase in income compared to a neutral budget goes to the poorest 30 per cent of the population. The richest 30 per cent, by contrast, contribute a net €59 million to the proposed tax and welfare package.

Looking at families, those who benefit most are the single unemployed, non-earning couples, lone parents and retired households. Among earning families, those with children do better.

We can also consider the impact on relative income poverty of the proposals. Diagram 2 shows a significant and consistent fall of between 1.50 per cent and 1.85 per cent in households below 50, 60 and 70 per cent of median income, as compared to a wage-indexed budget. The reduction is greatest for poorest households. Furthermore, the gap by which households are below these thresholds narrows in the Combat Poverty budget.

Diagram 1: Distributive impact of Combat Poverty 2005 Budget proposals, benchmarked with budget indexed by wages (% gain by equivalised disposable income per decile)

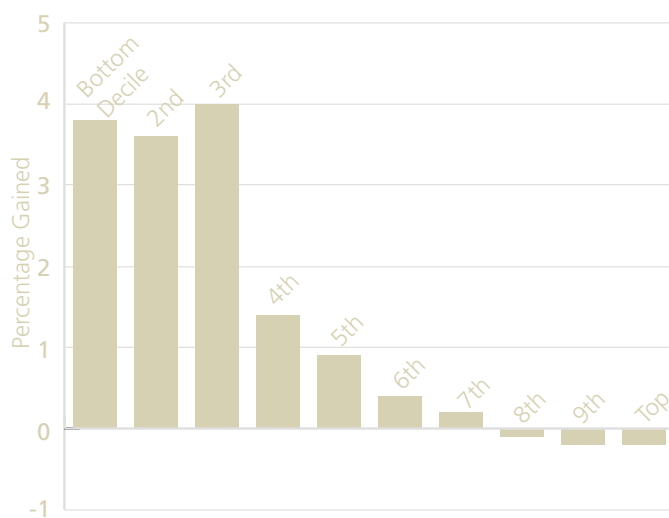
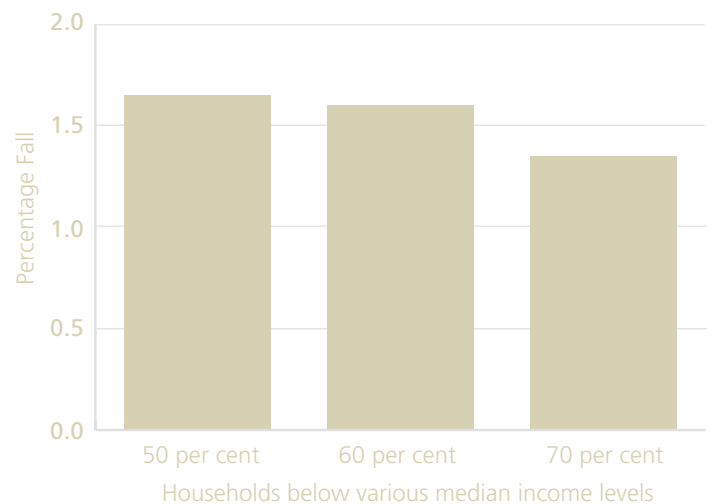


Diagram 2: Impact of Combat Poverty 2005 Budget proposals on relative income poverty, benchmarked with budget indexed by wages (% fall in households below median income)



15 Comparative costs of tax/welfare proposals

| Proposals cost (€m) | SWITCH costs (€m) | Official |
|--|-------------------|--------------|
| Increase personal rates by €12 | 612 (639 gross) | 581 |
| Increase adult rates by €9 | 46 (50 gross) | 55 |
| Increase child benefit by €17.60 per month | 226 | 239 |
| Increase PAYE tax credit by €240 per annum | 295 | 305 |
| Total | 1,179 | 1,180 |