

# Policy Submission

## **Submission on Supplementary Budget 2009**

**March 2009**

## 1. Introduction

Combat Poverty makes its submission on Supplementary Budget 2009 in accordance with its statutory remit to advise government on all aspects of public policy pertaining to poverty. The submission is informed by the tax/welfare programme of Combat Poverty and also draws on the agency's work on health inequalities, fuel and food poverty and educational disadvantage. The submission is framed around the Government policy objective to regain control over the exchequer finances and, in particular, to reduce the Exchequer Borrowing Requirement to circa 9.5 percent of GDP. It is also informed by the *National Action Plan for Social Inclusion 2007-2016*, in particular the Government target to reduce consistent poverty to between 2 and 4 per cent by 2012 and the associated EU policy commitment to make a decisive impact on (income) poverty by 2010.

The central theme of the agency's submission is that the Supplementary Budget 2009 should not diminish the Government focus on reducing poverty, especially in a period of increased poverty risk, arising from rising unemployment, falling household income and higher levels of over-indebtedness. It is acknowledged that the Government has to reduce public expenditure and to raise tax revenue in order to control the budget deficit. This goal should not conflict with protecting those in poverty and improving the effectiveness of welfare provision to address the new poverty challenges. In particular, we need innovative measures to support employment and to enable those who lose their jobs to quickly return to work.

## 2. Context for Supplementary Budget 2009

There are three challenges facing Supplementary Budget 2009:

- The decline in economic activity and the consequent rise in unemployment
- The crisis in the public finances, with a projected budgetary shortfall of between €4 and €6 billion in 2009

- The increase in poverty risks due to falling household income, higher levels of over-indebtedness and reductions in public services.

Here we focus on the third issue, increased poverty risks. Combat Poverty is preparing a research paper on this topic, which it will publish shortly. Our starting point is the 16.5 per cent of the population (circa 730,000 persons) who are 'at-risk-of-poverty' (using a threshold of 60 per cent of median income) and the subset of 5.1 percent of the population (c 225,000 persons) who are in 'consistent poverty' (at-risk-of-poverty and deprived of basic necessities<sup>1</sup>). The figures for children (0-17 years) are worse, with 20 per cent 'at-risk-of-poverty' and 7.4 per cent in consistent poverty.<sup>2</sup> Ireland's level of income poverty is higher than the EU average and is well above the best performing countries which have poverty rates of between 10 and 12 per cent.

It is likely that the poverty figures will have increased in 2008 and 2009 due to higher unemployment and reduced household income. Higher unemployment will increase the number of people vulnerable to poverty as the unemployed are between 6 and 13 times more likely to be living in poverty than those in employment.<sup>3</sup> Unemployment rose from 4.5 per cent in the last quarter of 2007 to 7.7 per cent in the same period in 2008. This represents a figure of 170,000 people not in work. Based on the Live Register returns for February 2009, the unemployment rate has risen further to over 10 per cent. Of additional concern is the increased numbers out of work on a long-term basis. At the end of 2008, 40,500 people were out of work for more than a year. This represents almost a quarter of the total unemployed. Long-term unemployment is likely to exacerbate the severity of poverty.<sup>4</sup>

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<sup>1</sup> The 'at-risk-of-poverty' measure is a key EU indicator of poverty. 'Consistent poverty' is the preferred Irish Government poverty measurement.

<sup>2</sup> Central Statistics Office (2008), *Survey of Income and Living Conditions (SILC) in Ireland 2007*, Dublin: Stationery Office

<sup>3</sup> Ibid

<sup>4</sup> All figures are from the Central Statistics Office at [www.cso.ie](http://www.cso.ie).

### 3. Policy approach to Budget 2009

Combat Poverty acknowledges that Supplementary Budget 2009 is primarily about addressing the crisis in the public finances and the need to reduce the exchequer borrowing requirement by a combination of reduced public expenditure and increased tax revenue. There are significant choices to be made in how the pain is shared in society and Combat Poverty considers that it is better-off groups, who benefited substantially from budgetary policy over the last 10 years, who should now carry the burden of fiscal adjustment.

At the same time, fiscal policy initiatives, no matter how progressive, will be unsustainable and ineffective if not accompanied by measures to address the social effects of the economic downturn, in particular the growth in unemployment. Social policy cannot just stand still in the current environment, but must be re-focused to generate better outcomes in terms of access to employment, educational opportunity and basic living standards.

Combat Poverty advocates the following comprehensive policy approach to the Supplementary Budget:

- prioritise income tax increases over cuts in welfare expenditure
- maintain welfare rates and child income support
- support employment and enable the unemployed to return to work
- seek better value for money for welfare expenditure
- ensure user charges are in compliance with social policy
- address problems of over-indebtedness.

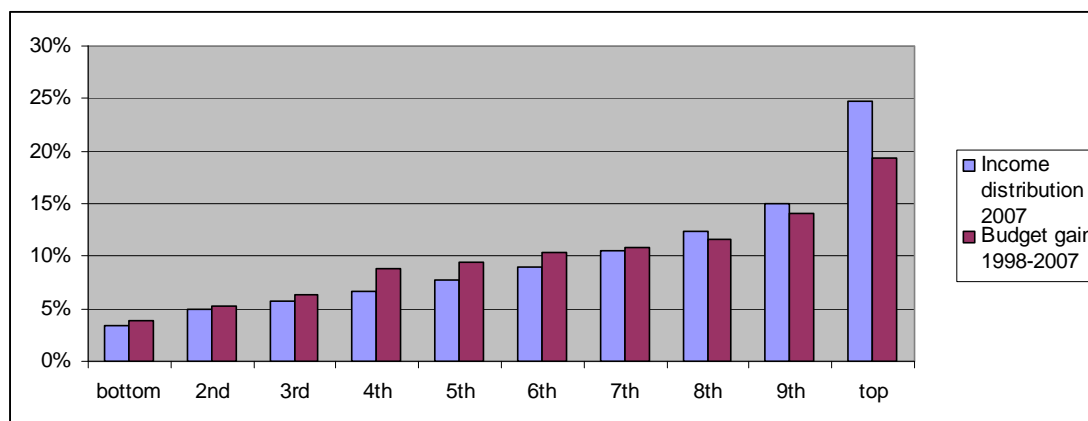
#### *Prioritise tax increases over cuts in welfare expenditure*

The Government has three main policy instruments available to it in terms of targeting household income: income tax, child benefit and social welfare.

Combat Poverty recommends that Government prioritises increases in income tax over cuts in welfare expenditure. This can be justified on three grounds. First, higher income groups have considerably more resources than lower income groups. Diagram 1 shows the inequalities in income in Irish

society. The top 40 per cent of the population control 60 per cent of all income, which is three times the income of the bottom 40 per cent. The richest fifth of the population has 40 per cent of all income, which is five times the income of the poorest fifth. Finally, the top decile receives a quarter of all income, which is over seven times the income of the bottom decile.<sup>5</sup>

**Diagram 1: Income distribution 2007 and distribution of gains from Budgets 1998-2007**



Second, the allocation by Government of additional tax/welfare resources over the ten year period 1998-2007 was primarily focused on tax reductions over welfare increases and higher child benefit. Of the €10 billion provided in tax/welfare improvements in this period, 65 per cent was channelled through tax reductions. Welfare payments got 19 per cent of the additional resources and child benefit (including the early childcare supplement) received 16 per cent. As a result, the distribution of these resources massively favoured higher income groups. Diagram 1 shows that over half of the package (56 per cent) went to the richest 40 per cent of households, with a third going to the top 20 per cent of households and a fifth going to the richest decile. By contrast, low-income groups received a far smaller share of these government resources. The poorest decile got 4 per cent and the poorest quintile got 10 per cent.<sup>6</sup> Not included in this analysis is the impact of the special savings

<sup>5</sup> Central Statistics Office (2008), *op cit*

<sup>6</sup> These calculations are based on the ESRI SWITCH tax/welfare model. See Walsh J (2007), 'Monitoring poverty and welfare policy 1987-2007', in M Cousins (ed) *Welfare policy and poverty*, Dublin: Institute for Public Administration and Combat Poverty Agency

incentive scheme. This cost the exchequer circa €3 billion and preliminary evidence suggests that these resources primarily went to better-off households.

Third, income tax expenditures, such as discretionary tax reliefs and incentives, are a costly and regressive feature of the tax system. Tax expenditures reduce the fairness of the taxation system, as they violate the principle of equity, whereby people should pay tax in proportion to their ability to pay. Tax reliefs provide high-income individuals with opportunities to reduce their effective taxable income substantially. This is at odds with the principles of both vertical and horizontal equity and leads to reduced progressivity in the tax system. Thus, there is a double inequity associated with tax reliefs. On the one hand they reduce the tax base, thereby imposing higher tax burdens on average households not in a position to avail of many tax-relief schemes, and on the other hand they provide high earners with opportunities to avoid paying tax. Moreover, the economic climate has changed dramatically since the initiation of many of these tax expenditures.

Possible measures to increase the yield from income tax are:

- increase the income levy, especially at the higher income range
- abolish the ceiling for employee's PRSI
- curtail tax expenditures on pensions, medical costs, health insurances, mortgage interest relief and various investment reliefs.

There is an increasing reliance on indirect taxes to generate government revenue. Research by Combat Poverty has indicated that indirect taxes have a disproportionate impact on low-income groups.<sup>7</sup> We would advise that these taxes should not be further increased and, if possible, that they be reduced on items essential to low-income families.

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<sup>7</sup> Alan Barrett and Caeman Wall (2006), *The Distributional Impact of Ireland's Indirect Tax System*, Dublin: Combat Poverty Agency

### *Maintain welfare rates and child income support*

We now address the policy approach to welfare rates and child income support. A key policy objective for Supplementary Budget 2009 should be to protect the living standards of those at-risk-of-poverty. This can be achieved by ensuring that adult welfare rates, in particular the minimum welfare rates, are not reduced. There are four main reasons why welfare rates should be maintained:

- Welfare rates are the main determinant of poverty levels in Ireland, reducing poverty by up to 60 per cent. This poverty impact of welfare transfers has increased in recent years and is now close to the EU norm, though still below the 70+ per cent effect of the best performing countries. Thus, not alone will a cut in welfare rates be likely to increase poverty. It will further differentiate Ireland from European best practice.
- Welfare rates are not adequate to meet minimum essential budgets. Research by the Vincentian Partnership for Social Justice shows that only 15 out of a sample of 27 low-income household types are able to afford minimum essential budgets.<sup>8</sup> The remaining 12 households experience significant budget shortfalls and are vulnerable to indebtedness in order to make ends meet. The experience of the Society of St Vincent de Paul in having to supplement household expenditure on basic living costs supports this conclusion.
- The recent decline (February 2009) in the annual consumer price index of 1.7 per cent does not support a view that basic living costs are falling. The main driver for the reduction in the consumer price index is lower mortgage rates (down by 26 per cent on the year), which is unlikely to benefit welfare recipients. Excluding mortgage interest rates, the consumer price index in fact rose by 0.5 per cent in the last year. Annual food costs, which account for up to a third of income in the

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<sup>8</sup> See [www.budgeting.ie](http://www.budgeting.ie)

poorest households, increased by 0.8 per cent. Also, the cost of utilities and local charges is up by 11 per cent, which will have a bigger impact on low-income households. The decline in clothing and footwear costs of 11 per cent will however benefit poorer households.

- Maintaining welfare payments boosts economic demand and directly supports agricultural production and employment in the retail and other sectors of the Irish economy.

What should the policy approach be in regard to child income support? It can be argued that child benefit should be reviewed on the basis that it is a universal payment that is received by better-off families as well as those on low incomes. However, child benefit is now the dominant form of child income support and any reduction will adversely affect poorer families. Furthermore, child benefit is a payment targeted at children and mothers across all income categories. Combat Poverty's preferred approach to restricting the payment, if this is required for budgetary reasons, would be to tax it. An across the board reduction in rates or means testing of the payment are not favoured. This matter is under review by the Commission on Taxation and Government should await the outcome of its deliberations.

The same arguments do not hold as strongly for the other universal payment, the early childcare supplement. If cutbacks are required in child income support, it is the early childcare supplement and not child benefit at which they should be targeted. At the same time, low-income households should be compensated for any losses. We make specific proposals for reform of the early childcare supplement later in the submission.

As argued previously with regard to adult welfare payment, the main instruments of targeted child income support – qualified child allowances, family income supplement, clothing and footwear allowances and in-school supports such as free meals and books – should not be altered.



### *Support employment and enable unemployed people to return to work*

Due to the economic downturn, many businesses are experiencing trading difficulties and have to reduce staff numbers to survive. A person who moves from employment to unemployment no longer contributes tax and PRSI and becomes a financial burden on the state (at an estimated cost of €20,000). Unemployment also brings exposure to an increased risk of poverty. It is proposed that incentives be introduced to secure existing employment levels, especially targeting those in vulnerable employment. Such incentives may be less costly than the financial cost of unemployment.

It is critical that policy seeks to minimise the duration for which people are unemployed, as long-term inactivity will diminish work skills and make re-employment more difficult. It is proposed therefore that education, training and employment programmes are targeted at the unemployed who are likely to face the greatest difficulties in returning to work.

### *Seek better value for money in welfare expenditure*

Combat Poverty believes there is scope to achieve better value for money from the welfare budget. We identify three mechanisms to achieve this:

- Target cash resources towards greatest social need. For example, the early childcare supplement could be better targeted to directly fund access to pre-school provision for low-income children aged 3 and 4 years. This would be in line with the original proposal from the Commission on the Family. This would require an enhanced (voucher) payment of €3,000 per child per annum to enable low-income families to purchase pre-school education from their choice of service provider. Where families already receive pre-school education at no or at a reduced charge, the payment would be reduced accordingly. The resources for this would be taken from within existing expenditure.
- Link income support with supporting capital measures. The welfare system provides additional cash subsidies towards items such as private rented accommodation and home heating/fuel. Frequently,

these do not represent good value for money because of deficiencies in the quality of housing. Linking income subsidies with measures to improve housing conditions could lead to better outcomes. For example, recipients of the fuel allowance should be prioritised for home improvements under the Warmer Homes Scheme. Another option would be to replace the smokeless coal allowance with a capital grant for switching to energy efficient heating systems. Similar value-for-money reforms could be made in the rent and mortgage supplement by improving the range and quality of social housing that is available.

- Increase the bargaining power of welfare beneficiaries. There are many cases where welfare recipients pay more for services because of the weak bargaining power, for example, financial services, fuel, food. Schemes should be developed which maximise the buying power of low-income households. For example, the introduction of basic bank accounts, combined with universal banking, could enable households to get reductions on their utility bills and access cheap credit facilities. Similarly, we are beginning to see the emergence of tariff competition among public utilities. The Government could negotiate reduced tariffs for electricity, gas and other energy supplies where households are availing of fuel subsidies or free electricity or gas schemes.

*Ensure any user charges are in compliance with social policy objectives*

In recent years, different arms of the state have introduced user charges for the provision of public services as a way of defraying costs. Generally, user charges impact most on low-income households unless an effective waiver system is in operation. The most high profile example is waste collection charges, operated by local authorities and private service providers. A recent review by the Office of the Ombudsman of waste collection charges concluded that the administration of waste management services does not make adequate provision to mitigate the cost burden on low-income households. More generally, the report notes that the current model for privatisation of public services such as waste management can act as a

barrier to public authorities in exercising their social policy obligations.<sup>9</sup> Existing and any proposed further user charges should be in compliance with social policy objectives.

#### *Address problems of over-indebtedness*

Over-indebtedness refers to a persistent inability to repay the instalments associated with credit agreements and household bills (such as utility bills). Over-indebtedness is associated with people in poverty, those on lower than average incomes (such as social tenants and lone parents) and those who have experienced a major income drop for reasons of ill-health, unemployment and redundancy. Surveys in recent years have estimated that, on average, between 7 and 10 per cent of households experience problems with arrears and/or have to borrow for essential expenses.<sup>10</sup> Current trends of increasing unemployment and decreasing incomes are likely to increase the numbers who are over-indebted. Also, it is likely that newly over-indebted people will have multiple creditors and higher levels of debt. These problems will be more complex, longer-term and harder to resolve than heretofore. Three indicators suggest that debt problems are on the increase:

- First, the number of people experiencing mortgage arrears has increased substantially. According to the Financial Regulator, 1.44 per cent of residential accounts (or nearly 14,000 mortgage accounts) were three months or more in arrears as at June 2008, an increase of nearly 24 per cent compared to the end of December 2006.
- Second, the numbers of people seeking help from the Money Advice and Budgeting Service (MABS) have risen and services are becoming increasingly stretched. Recent data published by MABS, for example, show that there was a 33 per cent increase in queries to MABS services in the first half of 2008 compared to the same period in 2007.

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<sup>9</sup> Available at [www.ombudsman.gov.ie](http://www.ombudsman.gov.ie).

<sup>10</sup> Central Statistics Office (2008), *op cit*

- Third, Ireland has experienced a dramatic increase in financial vulnerability relative to other European countries. According to the respected Genworth Index (a periodic survey of peoples' feelings about their current and future financial situation carried out in 12 EU countries), the Irish population has moved from a position of feeling relatively financially secure in Summer 2007 to being the third most financially vulnerable by Autumn 2008.<sup>11</sup>

Recently, the Government put in place measures to deal with one aspect of over-indebtedness, namely mortgage debt. These measures, particularly the moratorium on repossession proceedings, do not go far enough. Also, the restrictive focus on mortgage debt ignores the majority of households at risk of over-indebtedness, such as those in rented accommodation, owner occupiers and those living with their parents. It also ignores those with other types of secured housing loans such as for home improvements. The “mortgage problem” is thus only one part of a much wider problem of household over-indebtedness. The current crisis presents an opportunity to overhaul our approach to indebtedness and over-indebtedness, in line with the changes made by other European countries to their systems, laws and procedures at the time of a previous recession in the early 1990s. Combat Poverty will shortly be publishing recommendations as to how Government can effectively address over-indebtedness through a combination of preventative, ameliorative and rehabilitative measures.

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<sup>11</sup> Genworth Financial (2008), *The Genworth Index: measuring consumer financial vulnerability in 12 European markets*, Vol 2, 4<sup>th</sup> Quarter, 2008.