Opening Statement – Oireachtas Committee on Budgetary Oversight

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Introduction

Thanks to the Chair for the invitation to the ESRI to appear before the Committee. I am Dr. Karina Doorley, and I am joined by my colleague Mr. Mark Regan. We are grateful for the opportunity to appear before the Committee today to provide our views on the Budgetary tax package, temporary vs. permanent measures and social protection income thresholds.

Budget 2023

Budget 2023 was framed as a cost-of-living budget. Thanks to a strong economic performance, evident in the labour market and Government exchequer returns, government was in a position to allocate significant resources, without running a budget deficit, to alleviate some of the cost-of-living pressures experienced by households and businesses.

Year-on-year inflation in Ireland and the Euro Area stood at 9.0 and 9.1 per cent, respectively, in August. The ESRI has forecast an inflation rate of 6.8% in 2023. However, the effects of inflation vary by household type. In Ireland, low income, rural and elderly households have experienced higher inflation as more of their consumption relates to food and fuel. Households in the lowest income quintile (or fifth) of the population experienced inflation of 9.8% in the period August 2021-2022 while households in the highest income quintile experienced inflation of 8.1%. Similarly, elderly households and rural households experienced inflation of 9.7 and 9.8 per cent respectively compared to 9 and 9.7 per cent for working-age and urban households.

The households experiencing a higher rate of inflation are also those who are more likely to be dependent on fixed incomes such as social welfare or pensions and less likely to benefit from wage increases, forecast to be 3.5 and 4.5 per cent this and next year.[1]

Taxation

Budget 2023 contained measures directed at maintaining household standards of living. On the taxation side, the standard rate cut-off band was increased by more than forecast inflation while tax credits were increased by less than forecast inflation.[2]

Unlike income tax credits and bands, most of the corresponding thresholds for PRSI and the USC were held fixed in nominal terms, amounting to an effective PRSI and USC increase for many taxpayers.

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[1] Quarterly Economic Commentary, Autumn 2022 (esri.ie)

[2] The Central Bank (2022) and the Department of Finance (2022) have forecast inflation in the Harmonised Index of Consumer Prices of 6.3% and 7.1% respectively for 2023.

Although most excise duties were frozen in cash terms (amounting to an effective cut given rising prices), Tobacco Products Tax was increased. The VAT on newspapers and miscellaneous health items was reduced to zero. There was also a well-flagged increase to the carbon tax which was offset on petrol and diesel by the elimination of the NORA levy and the extension of temporary cuts in non-carbon motor fuel duties.

A number of taxation-related interventions in the housing market were designed to increase affordability and availability of housing. A new €500 income tax credit for renters was announced as well as a vacant home levy. Another extension to the Help to Buy Scheme was announced, despite concerns that it is poorly targeted towards its stated aims and likely to fuel house price growth. In addition, the potential for the 10 per cent levy on concrete products to be passed on to future residents of newly built properties may further impact housing affordability.

Welfare

On the welfare side, Budget 2023 saw permanent increases to most social welfare payments. Apart from the €40 increase to the Working Families Payment income threshold, these were all below forecast inflation and follow real cuts to these payments in Budget 2022. In line with previous budgets, increases to social welfare payments were announced as a flat euro-per-week amount which, given the different base rates of social welfare payments, means a different proportionate increase for pensioners, those of working age, young jobseekers and other cohorts reliant on social welfare. While the euro-per-week announcement is easy to communicate, it risks changing the connection between rates of payment and income adequacy in an ad-hoc manner.

We estimate that the substantial package of temporary measures announced for 2022 and 2023 will make up for the real cut to permanent social welfare rates. These temporary measures include some targeted payments (such as the Autumn bonus payment and lump-sum payments to recipients of some welfare payments) and some universal measures (such as the double child benefit payment and the electricity credits).

Changes to the National Childcare Scheme (NCS), which subsidises registered childcare, were also announced. The Universal subsidy – which currently pays €0.50 per hour for children under 15 – will be increased to €1.40 per hour. However, as the thresholds for the income-assessed component of the NCS have been fixed in nominal terms since Budget 2019, some households will lose their entitlement to this more generous subsidy due to wage growth.

Permanent vs. temporary measures

In our post-budget analysis, the ESRI compared the direct and indirect tax and welfare measures – permanent and temporary - announced in Budget 2023 to a price-adjusted set of policies for 2022. Figure 1 illustrates the impact of Budget 2023 across the distribution of household income, adjusted for family size, with the population divided into ten equally sized groups (deciles) ordered from lowest- to highest- income, left-to-right. The effect of direct tax and welfare measures, indirect tax measures, temporary measures and changes to the National Childcare Scheme are shown separately with the total effect represented by the solid blue line.

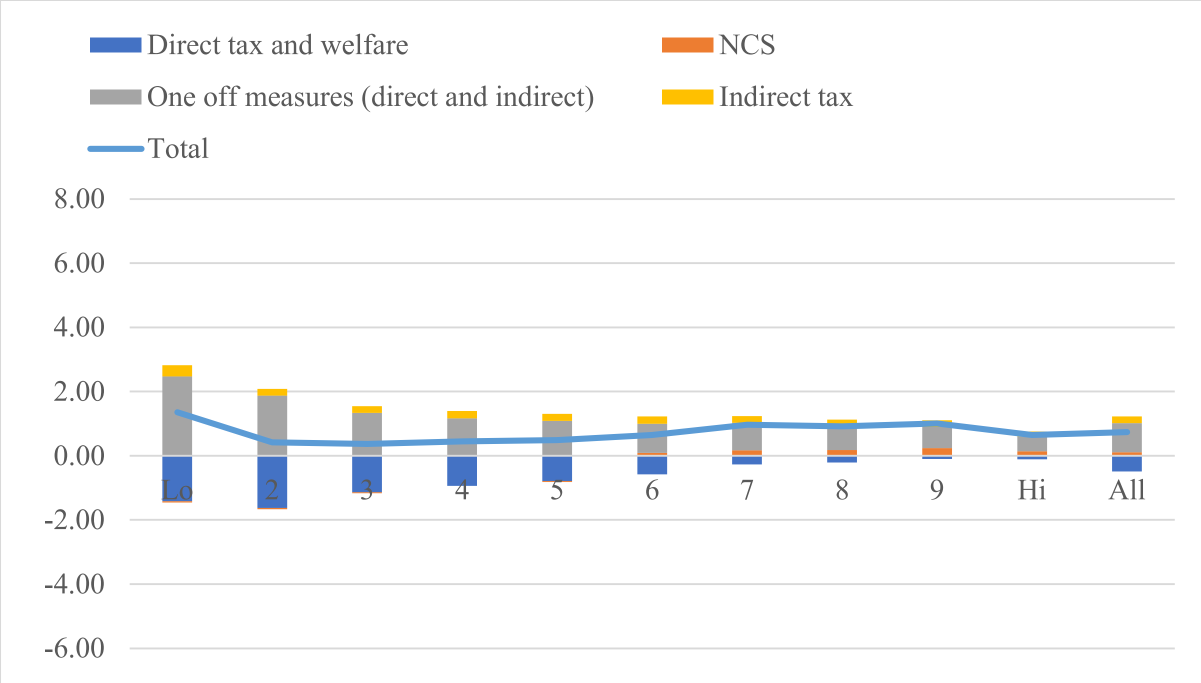

Figure 1 The effect of Budget 2023 on income distribution, compared to inflation-proofed 2022 policies

The overall effect of Budget 2023 compared to price-adjusted 2022 polices is that, on average, households are slightly better off (by 0.75 per cent of disposable income). There are small average gains in all income deciles. This does not equate to an increase in real income, which will depend on how wages, employment and other factors evolve in 2023, but rather shows that the contribution of policy changes to real income changes is expected to be positive. These gains are driven entirely by one-off measures. Despite average gains across the income distribution, detailed analysis showed that some households who are more likely to be reliant on social welfare – such as pensioners and lone parents – are likely to experience average income losses.

Disregarding one-off measures entirely and comparing the effect of permanent 2023 policy measures to inflation-proofed policies for 2020 gives an indication of the more medium-term challenges facing households and policy-makers. Compared to indexing tax and welfare policies in line with inflation since 2020, Budget 2023 leaves households worse off on average. The permanent budgetary changes – specifically the extension of the standard rate cut-off band – benefit higher income households most which leads to steeper losses for lower income households compared to higher income households.

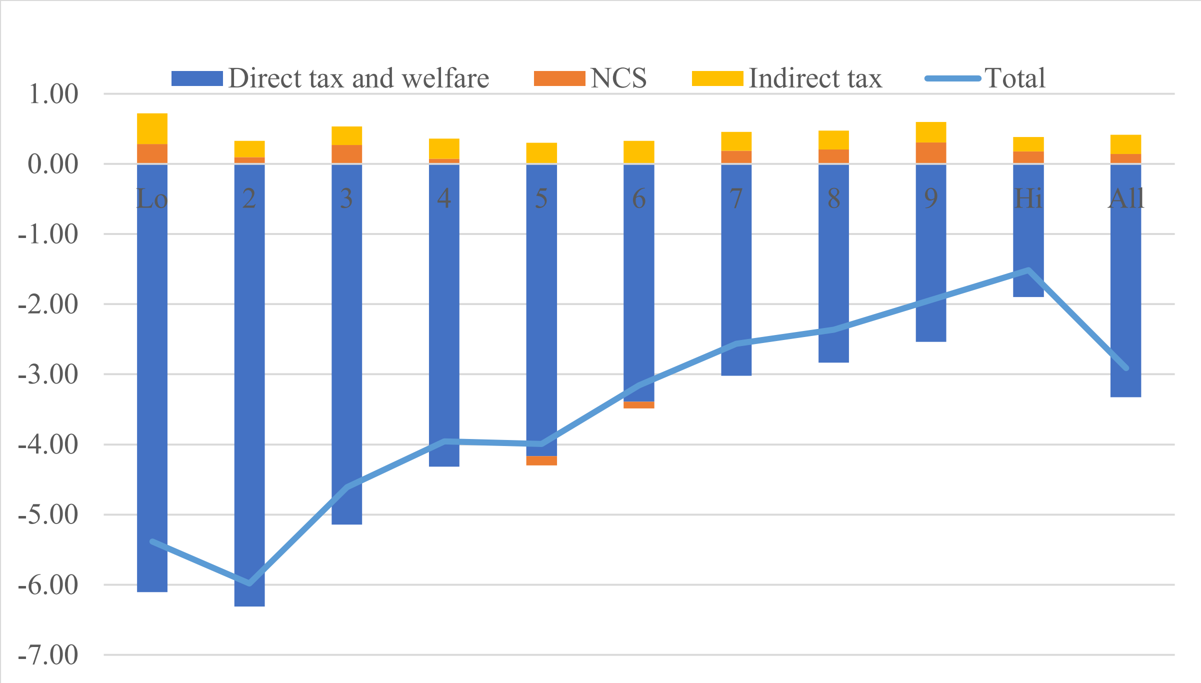

Figure 2 The effect of permanent Budget 2023 measures, compared to inflation-proofed 2020 policies

Conclusion

Budget 2023 introduced a range of permanent and once-off cost-of-living measures. While these will, on average, insulate households relative to a price-adjusted benchmark, the one-off nature of many of the measures means an erosion of the real purchasing power of structural rates of payments within the social welfare system. There may be a need for further once-off cost-of-living measures in the Winter of 2023 if price rises, particularly energy related, persist next year. Targeted measures will reduce the risk of adding additional demand-side inflationary pressures to the economy.

Over successive Budgets, rates of welfare payments have been incremented by fixed amounts. This translates to ad-hoc proportionate increases for different cohorts in receipt of welfare. If this pattern of increase continues, it will erode the relativities implicit in the social welfare system and weaken the link between rates of payment and income adequacy. Once the need for one-off measures to insulate households from inflationary pressures has passed, policy-makers may wish to consider benchmarking social welfare payments to re-instate this link between payments and income adequacy.