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Houses of the Oireachtas

An Oifig Buiséid Pharlaiminteach

Parliamentary Budget Office

Pre-Budget 2024: Selected Impacts on Households

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Séanadh

Disclaimer

Key Points

- Government's use of one-off lump sum payments may result in an overall Budget package that is progressive (impacting lower-income households proportionately more). However, this approach does not recoup lost purchasing power for lower-income households in the medium-long term. An indexation approach to welfare payments (and tax bands/credits) would be a preferable approach to deal with income adequacy challenges and provide certainty to households.

- Public Sector wage growth has not kept pace with private sector wage growth in recent years. Recent years of high inflation have resulted in the real value of Public Sector earnings fall to 2012 levels. At a time when there is strong demand for teachers, nurses and Gardaí, and a tight labour market, this makes Public Sector recruitment and retention a significant challenge for Government.

- Using the Pensions Commission approach to State Pension benchmarking, the current value of the Contributory State Pension is circa €9 below the amount required to meet the 34% of average earnings benchmark. Accounting for forecast 2023 wage growth, a €25 weekly increase to the State Pension may be required to meet the benchmark by end 2023.

- The Government targeted the National Childcare Scheme universal subsidy rate in Budget 2023, increasing the hourly subsidy from €0.50 to €1.40. However, PBO modelling using SWITCH (the ESRI's tax-benefit model), shows that targeting funds to the four maximum subsidy rates would help lower-income households proportionately more.

- Child Benefit rates may increase in January 2024. However, SWITCH modelling shows that targeting equal funds towards Qualified Child Increases and/or Working Family Payment is a more progressive approach, benefiting lower-income households proportionately more.

- Universal energy credits may be a recurring feature in Budget 2024. However, a targeting of funds towards, for instance, fuel allowance recipients would be a more progressive approach.

- Fuel tax restoration will impact lower-income rural households more than others. The often regressive nature of environmental taxes require policies to include measures to help offset this burden.

Select Household Issues

Moving from the broader macro-picture to looking at the impact of potential budgetary policy on households, this section examines:

(1) Real earnings/income growth over time, including earnings by sector,

(2) The issue of Contributory State Pension indexation,

(3) National Childcare Scheme (NCS) policy options,

(4) Child Benefit and alternative policy options,

(5) Energy credits/fuel allowance analysis and

(6) Urban/rural impact of fuel tax restoration.

The Child Benefit and energy credit analyses add to the ongoing discussion of universal and targeted measure approaches.

Budget 2023 was very progressive and performed well in comparison to a price-indexed baseline (Doolan et al., 2022).[1] However, much of the redistribution in Budget 2023 was achieved via lump-sum or one-off measures. **Avoiding the use of one-off measures in Budget 2024 would require core welfare payments to be raised very significantly to achieve the same distributional outcomes**. One-off lump sums do not regain lost purchasing power for lower-income households in the medium-long term, and are a temporary solution to income adequacy challenges. Indexation of welfare rates, to price or wage inflation, is one route that Government could follow to deal with income adequacy and provide certainty for households largely dependent on welfare income. Indexation would also help avoid fiscal drag (bracket creep[2]) for income taxpayers, by increasing rate bands in line with economic conditions.

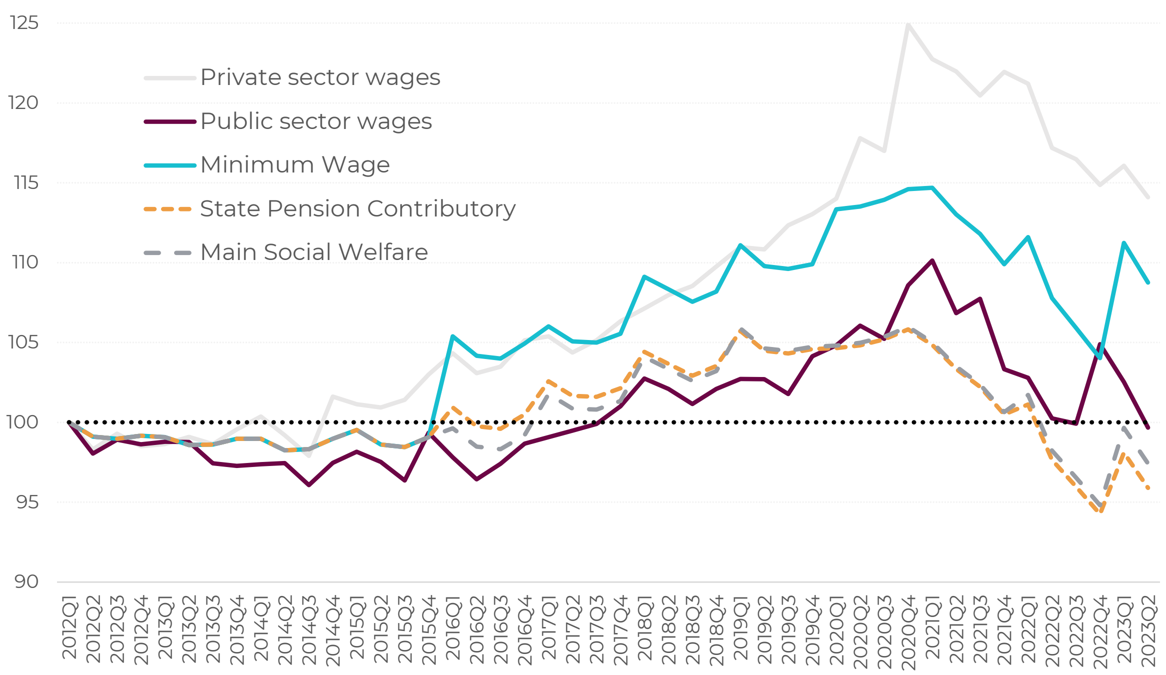
Real Earnings/Income Growth

Despite nominal wage growth (private and public sector combined) of 30.6% between Q1 2012 and Q2 2023, real wages have increased by only 8.8%, driven by exceptionally high inflation in the most recent years of the period. There has also been a large disparity in wage growth across sectors over this time. Private sector earnings have increased 14.1% in real terms since Q1 2012 and are almost at parity in real terms since Q1 2020 (0.1% increase). In contrast, public sector earnings have actually decreased by 0.3% in real terms since Q1 2012 and are down 4.9% since Q1 2020.

[1] Doolan, M., Doorley, K., Regan, M., Roantree, B., Distributional impact of tax and welfare policies: Budget 2023 (2022)

[2] Bracket creep in this instance refers to income tax payers moving from the standard to higher rate of tax due to wage growth, that may be less than price inflation, resulting in a decrease in real income.

Figure 1: Real Earnings / Income Growth 2012 – 2023 (2012Q1 = 100)



Source: Author's analysis of CSO data (earnings and CPI data).

For those earning the minimum wage, growth over the longer-term has mirrored growth for wages in general – up 30.6% in nominal terms and 8.8% in real terms, since Q1 2012. However, the minimum wage is down 4% in real terms since Q1 2020, again driven by high inflation in 2021 and 2022. This has eroded purchasing power for lower-income earners, a situation that will be partially alleviated by the introduction of the living wage, set to be 60% of median earnings[3].

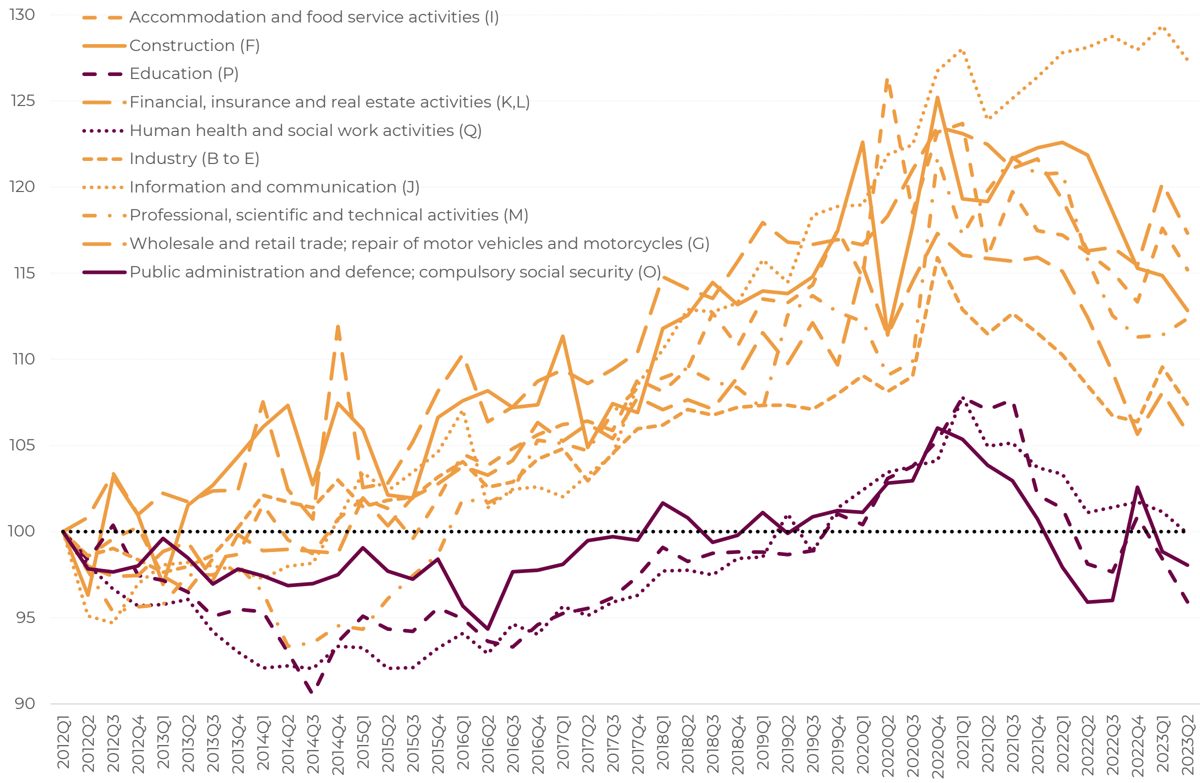
Those dependent on welfare income have fared worst over the period 2012 – 2023, excluding recent temporary lump sum payments which do not impact erosion of permanent purchasing power over the medium-long term. The Contributory State Pension has decreased 4.1% in real terms since Q1 2012. The core social welfare rate (which applies for instance to jobseekers' payments, disability allowance and one-parent family payment) has decreased 2.6% in real terms since Q1 2012. Since Q1 2020, the Contributory State Pension and the core social welfare rate have decreased in real terms by 8.4% and 7.1% respectively.

Although private sector earnings increases have been higher in sectors such as ICT, most private sector driven segments of the employed population have experienced real wage growth well above the public sector driven segments. In fact, as per Figure 2 below, and in accordance

[3] Department of Enterprise, Trade and Employment press release on the living wage, November 2022.

with the general public sector trend in Figure 1 above, all three public sector driven areas have experienced a decrease in real earnings since Q1 2012 – meaning the purchasing power of those working in the Public Service is lower in 2023 than it was in 2012.

Figure 2: Real Earnings Growth 2012 – 2023, by Sector (2012Q1 = 100)



Source: Author's analysis of CSO data (earnings and CPI data). Private sector driven sectors shaded **orange**, public sector driven sectors shaded **purple**.

Contributory State Pension Indexation

Increases to subsidiary payments, with differing eligibility criteria, and one-off lump sum payments do not address the adequacy of core weekly payment rates to those dependent on welfare. The largest of these groups are those in receipt of the Contributory State Pension, a potential candidate for the initial adoption of indexation (rates linked automatically to price or wage inflation). The 2021 Pensions Commission report[4] put forward a potential 34% of average earnings[5] benchmark for the Contributory State Pension. Although this benchmark was achieved up to 2020, with wage growth outpacing pension increases in 2021, 2022 and

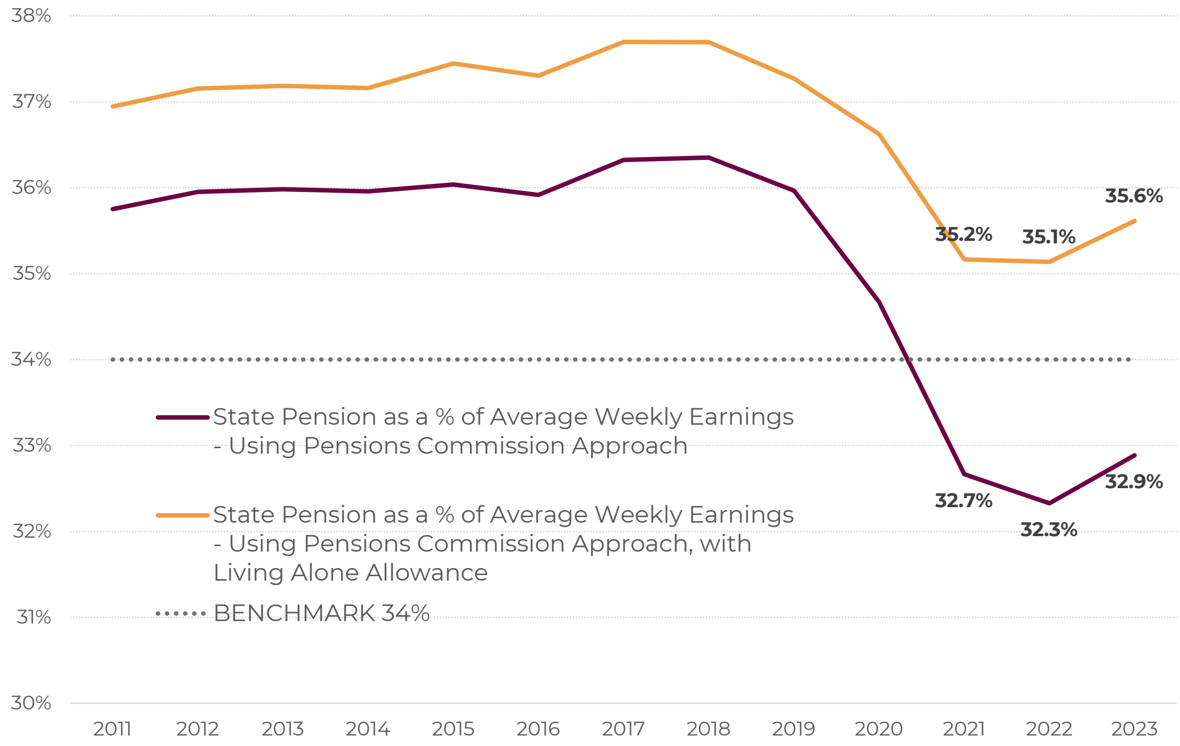
[4] Report of the Commission on Pensions, Technical Working Paper 4: Benchmarking and Indexation, 2021.

[5] Specifically average weekly earnings, excluding irregular and overtime earnings, and using the average of Q1 of the year in question and the three previous quarters.

2023, the State Pension now stands at 32.9% of average weekly earnings (35.6% when the living alone allowance is included).

A circa €9 increase on the current rate (€265.30) to €274.28 would reach the 34% benchmark – looking retrospectively. However, forecast 5.9% wage growth in 2023[6], indicates that an increase of circa €25 in the State Pension may be required to reach the 34% benchmark by end 2023.

Figure 3: State Pension as % of Average Earnings, 2011 - 2023



Source: Author's analysis of CSO earnings data.

National Childcare Scheme Subsidy Options

Following Budget 2023, the universal NCS subsidy rate (which is also the minimum rate in the income-assessed scheme) increased from €0.50 per hour to €1.40 per hour. This was a substantial change and helped reduce the cost of childcare, a key barrier to increasing female labour force participation, considerably. However, PBO analysis using SWITCH[7] shows that targeting monies towards the maximum subsidy rates in the income-assessed scheme would help the most vulnerable families substantially more than increasing the universal/minimum rate, which helps middle and upper-income families proportionately more[8].

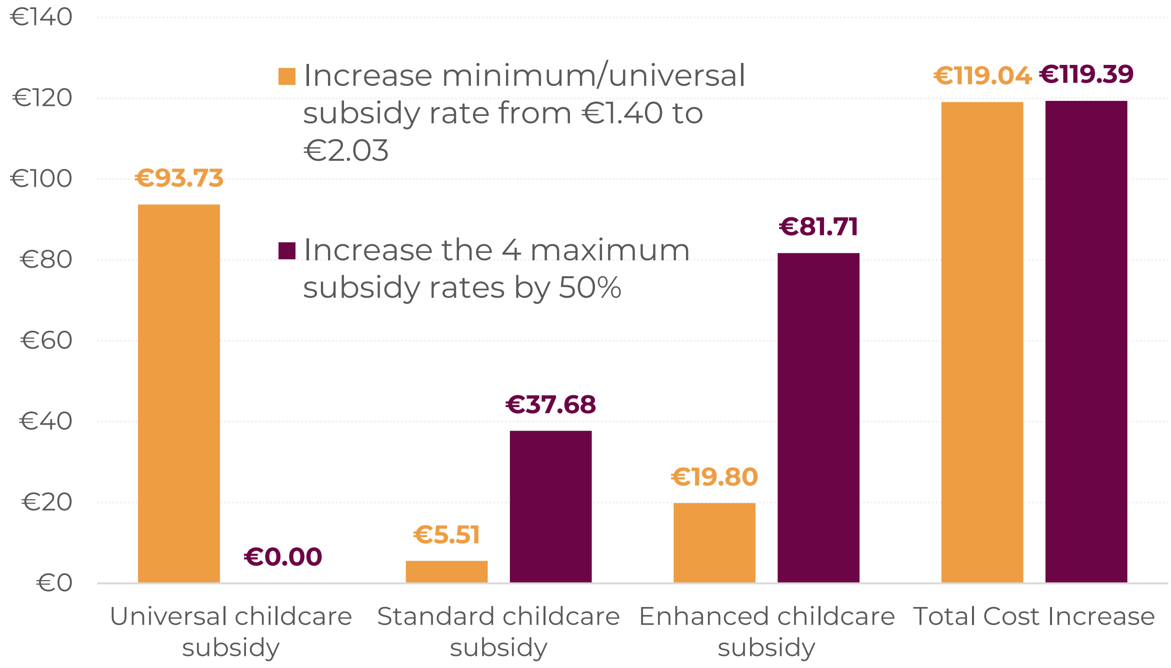
[6] Central Bank, Quarterly Economic Bulletin Q3 2023

[7] SWITCH is the ESRI's tax-benefit microsimulation tool and is used by the PBO to assess the impact of tax and welfare policies on households.

[8] For more detailed analysis / further policy options, please see the interactive PBO dashboard on NCS subsidy options.

Figure 4 shows the indicative costs of increasing the universal rate for a cost approximately equal to the cost of increasing the four maximum rates by 50%.[9]

Figure 4: NCS Subsidy Policy Options, Cost in €m

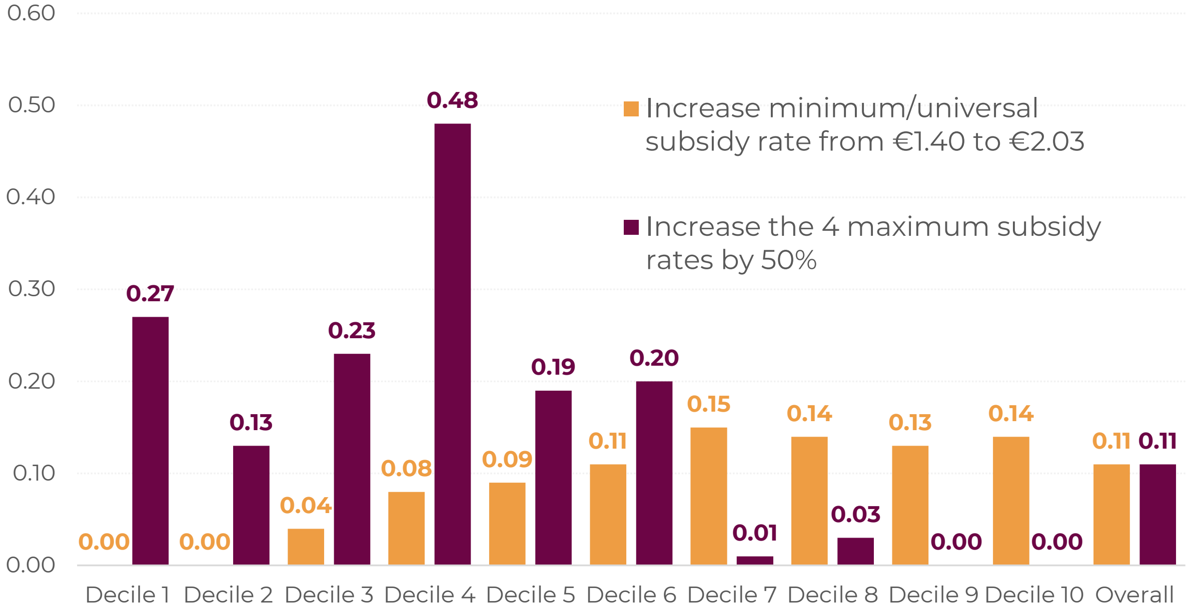


Source: Author's analysis using SWITCH.

Targeting the income-assessed maximum subsidy rates means costs fall onto the enhanced scheme and, to a lesser extent, the standard scheme (the use of these two schemes depend upon the work/study situation of the parents – 20 or 40 hours subsidised per week). Increasing the universal subsidy, as per the approach in Budget 2023, means costs fall mainly onto the universal scheme. Both approaches are estimated to cost circa €119m, but as per Figure 5 and Figure 6 below, the distributional impacts of these two approaches differ substantially. Targeting the maximum rates, rather than the universal rate, impact lower income households and lone parents proportionately more – key groups to incentivise into employment.

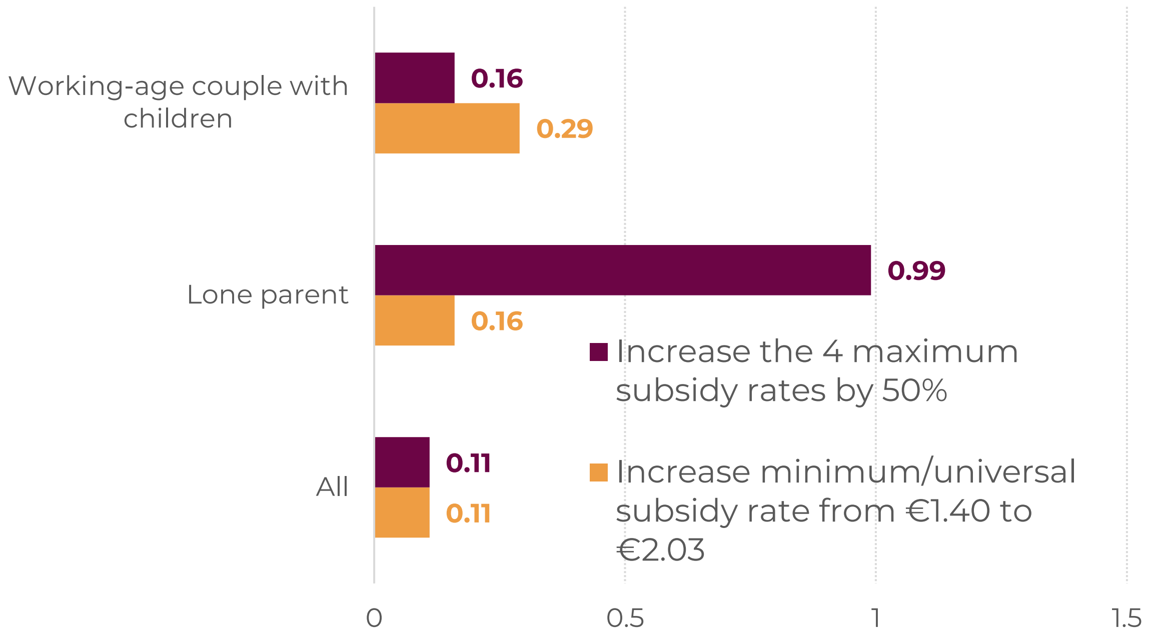
[9] Note – this is a hypothetical example for illustrative purposes only and is not a policy suggestion by the PBO.

Figure 5: NCS Subsidy Policy Options, Distributional Impact by Household Income Decile - % Change in Weekly Disposable Income



Source: Author's analysis using SWITCH.

Figure 6: NCS Subsidy Policy Options, Distributional Impact by Family Type - % Change in Weekly Disposable Income



Source: Author's analysis using SWITCH.

Child Benefit and Alternative Policy Options[10]

One option in *Budget 2024* for the Government to help families with the cost of living is to increase Child Benefit, a universal payment made to all families with children, currently €140 per month per child. Although this approach has advantages – simple application with less administrative burden and assists families across the income spectrum, the same amount of expenditure could be used to target the most vulnerable families in a more progressive way. The analysis below, using SWITCH, looks at two alternative options alongside Child Benefit – Working Family Payment and Qualified Child Increases[11].

Firstly, three policy options are presented below, all at a similar cost estimate – increasing Child Benefit to €150 per month per child, increasing all eight Working Family Payment income thresholds by €52 (resulting in an increase of up to €31.20 per week for recipients[12]) and increasing Qualified Child Increases by €10 per week for eligible welfare payment recipients (the third option results in a tax increase as these payments are taxable).

Table 1: Child Benefit and Alternative Policy Options, Exchequer Impact

Costs in €m	Tax impact on Exchequer	Welfare impact on Exchequer	Net impact on Exchequer
Increase all 8 Working Family Payment income thresholds by €52 per week	€0.00	-€136.63	-€136.63
Increase both Qualified Child Increase rates by €10 per week	€11.12	-€147.05	-€135.93
Increase Child Benefit from €140 to €150 per child per month	€0.00	-€140.46	-€140.46

Source: Author's analysis using SWITCH

However, the distributional impacts of these two targeted alternative approaches differ substantially to the distributional impacts of the

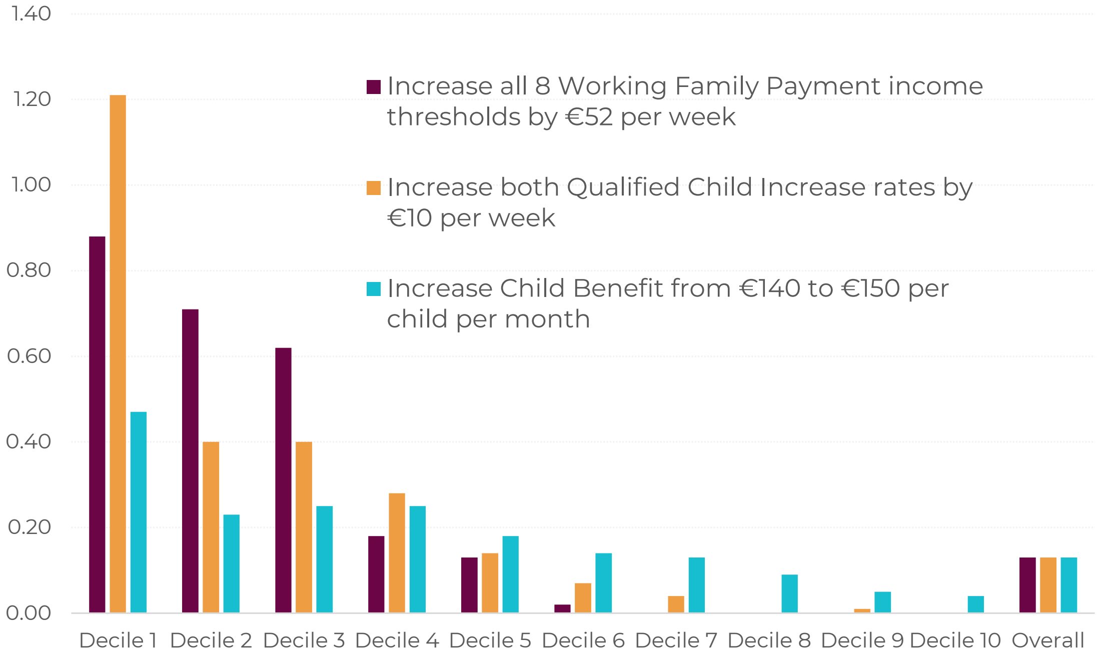
[10] For more detailed analysis / further policy options, please see the interactive PBO dashboard on Child Benefit and Alternative Policy Options.

[11] ESRI research suggests that targeting Qualified Child Increases and, in particular, Working Family Payment, are more effective ways to reduce at-risk-of-poverty rates for children than increases to child benefit, see Headline Poverty Target Reduction in Ireland and the Role of Work and Social Welfare, ESRI 2022. More recent research by the ESRI proposes a second-tier of Child Benefit, means tested, to help reduce child poverty rates. This research points to issues with both Qualified Child Increases (potential disincentive to work and Working Family Payment (not impacting non-working households), although it is unclear how the additional Child Benefit payment would avoid these issues.

[12] The take-up rate of WFP in SWITCH is modelled at 53% to obtain a figure close to the actual number of recipients in DSP administrative data. See ESRI research on take-up rate issues with WFP: ESRI Working Paper No. 750, The trouble with take-up, May 2023.

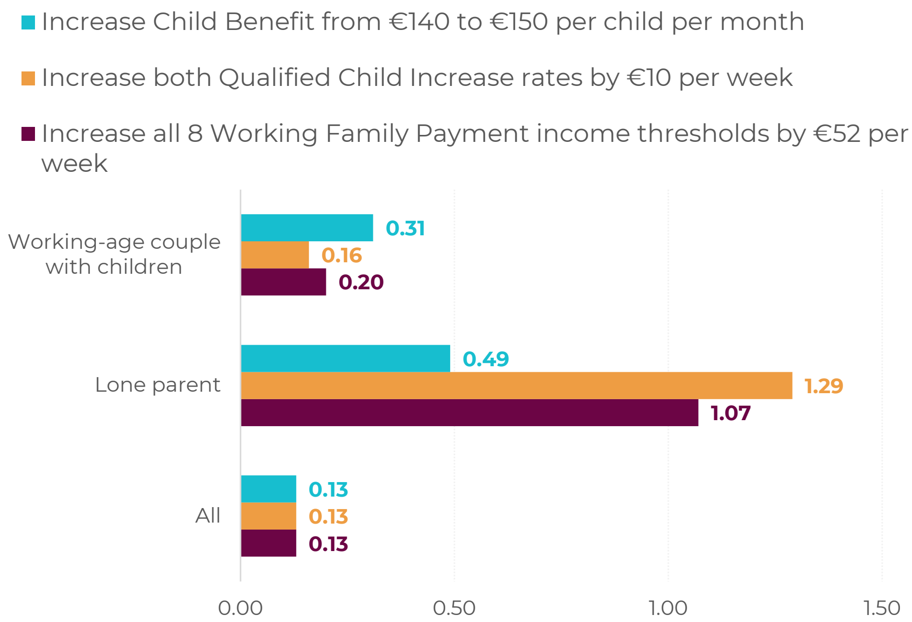
universal approach of increases to child benefit, with lower income households and lone parents benefitting more from the alternatives.

Figure 7: Child Benefit Policy Alternatives, Distributional Impact by Household Income Decile - % Change in Weekly Disposable Income



Source: Author's analysis using SWITCH

Figure 8: Child Benefit Policy Alternatives, Distributional Impact by Family Type - % Change in Weekly Disposable Income



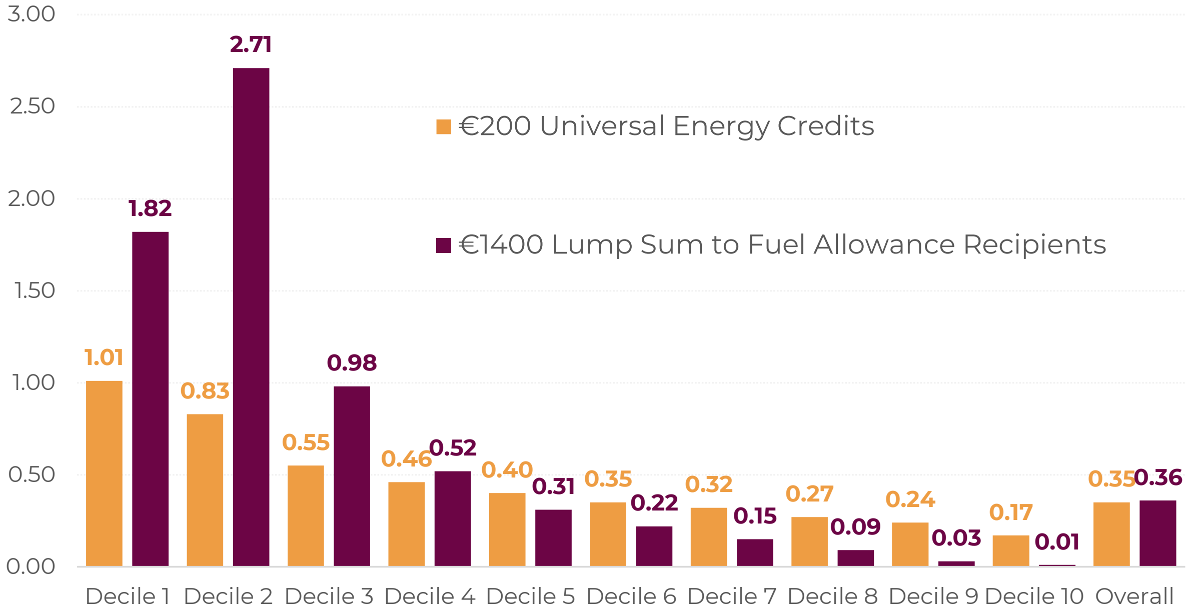
Source: Author's analysis using SWITCH

Universal Energy Credits v Fuel Allowance Lump Sum

Universal energy credits of €200 per household (at a net cost of €176.22 to the Exchequer when VAT on electricity is at 13.5%) costs circa €396.5m to the Exchequer in total. There were 386,846 fuel allowance recipients in 2022 according to Social Protection annual statistics[13]. Therefore, this amount could be targeted to fuel allowance recipients at a rate of circa €1,025 per household.

Figure 9 below shows a comparison of a €200 universal energy credit to a €1,400 lump sum to fuel allowance recipients only. €1,400, rather than €1,025, is used as fuel allowance is not modelled in SWITCH for all welfare recipient groups. It is primarily modelled for pension recipients. Compared to the actual number of fuel allowance recipients (386,846), SWITCH models the scheme for 279,390 recipients.

Figure 9: Distributional Impact of Universal Energy Credit v Fuel Allowance Recipient Lump Sum, by Household Income Decile - % Change in Weekly Disposable Income



Source: Author's analysis using SWITCH (fuel allowance not modelled for all recipients)

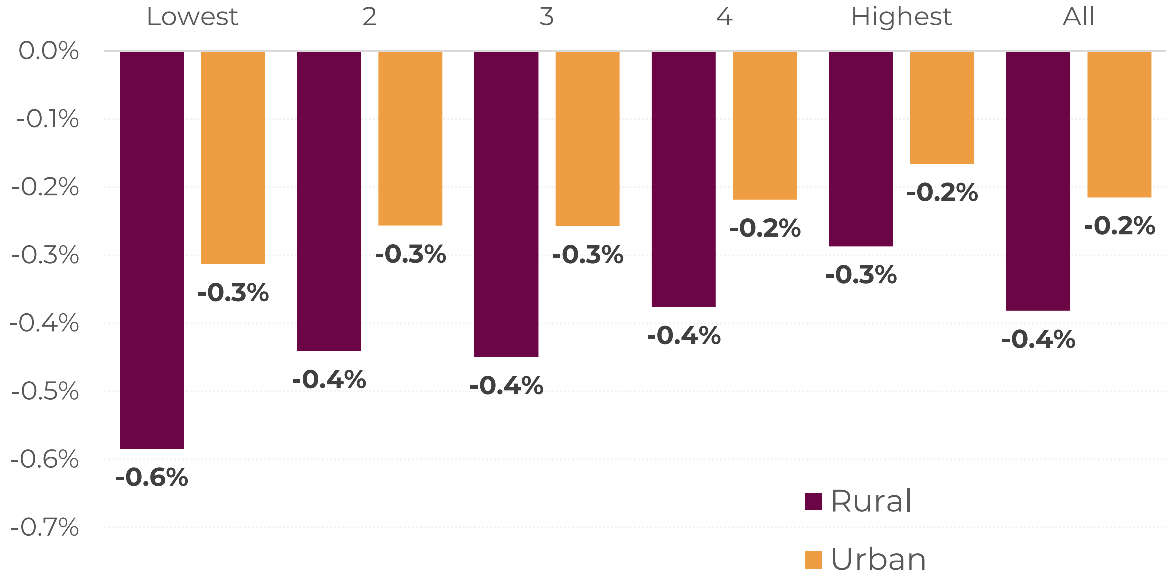
Based on this distributional impact analysis, it is clear that targeting these funds to welfare recipients, rather than as a universal energy credit, is more progressive, impacting lower income households proportionately more. The inclusion of all fuel allowance recipients at the lower lump sum amount would impact more households in the lower income deciles, albeit at a lower amount per household, remaining a more progressive approach.

[13] Statistical Information on Social Welfare Services, Annual Report 2022

Distributional Impacts of Fuel Tax Restoration

Distributional impacts by the urban/rural divide are an important consideration, in addition to the impacts by household income and family type. One policy area where the impacts by urban/rural differ substantially is excise duty on fuel, since rural households are more dependent upon motor fuel for travel. Fuel excise is to be restored, in stages, to early 2022 levels by the end of October 2023. This restoration of rates will disproportionately impact low-income households in rural areas, as per Figure 10 below.[14] Environmental taxes, such as excise on fuel and carbon tax, have a tendency to be regressive, if policies do not contain elements to offset the burden on lower income households.

Figure 10: Distributional Impact of Fuel Tax Restoration, by Urban/Rural Designation and Household Income Quintile - % Change in Weekly Disposable Income



Source: Author's analysis using internal PBO models.

[14] This analysis was conducted using the PBO's internal indirect tax microsimulation model, which draws on the CSO's Household Budget Survey data. The urban/rural designation of households is taken directly from the CSO survey data.

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