

Tax, Welfare and Work Incentives

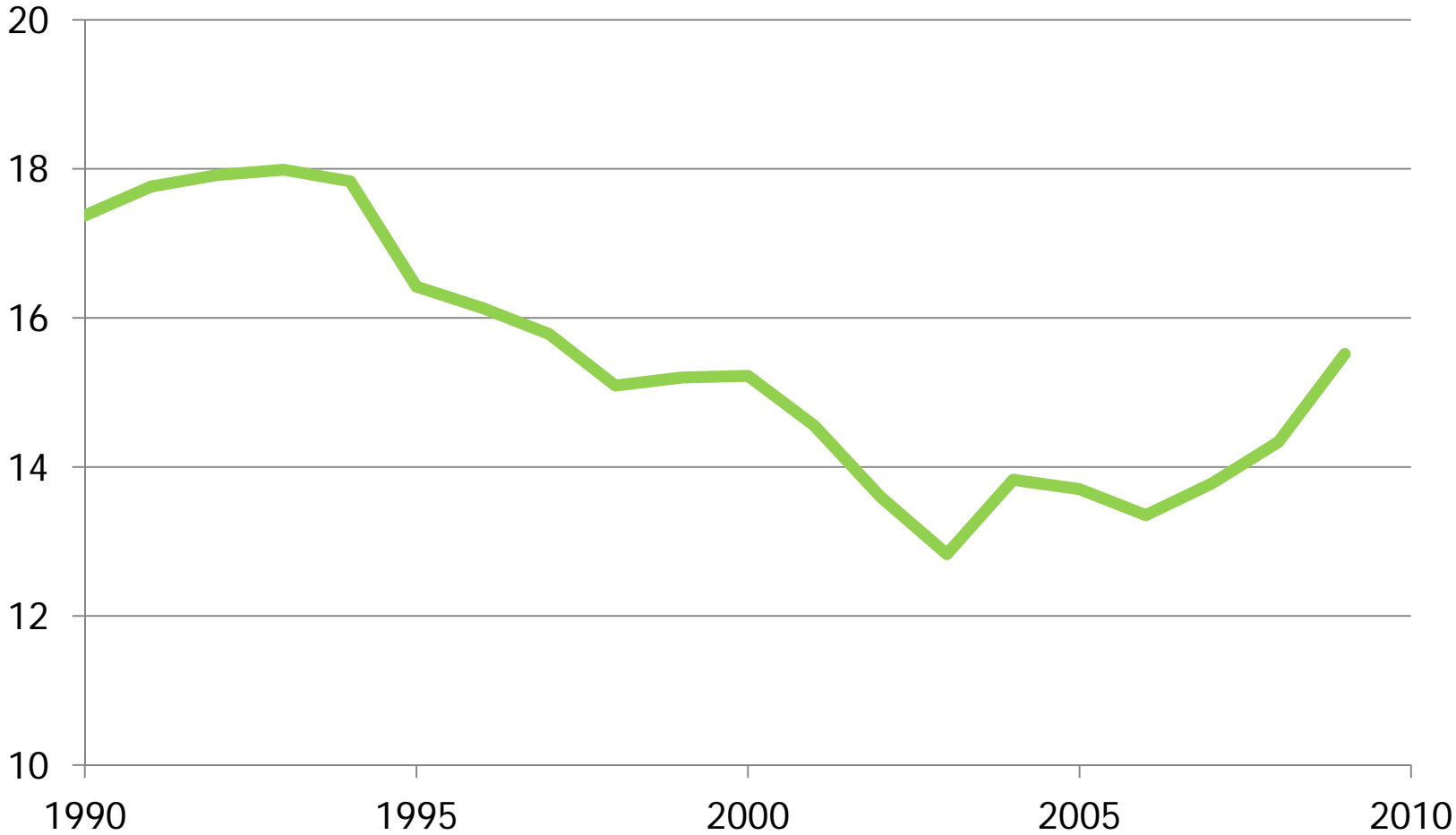
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Overview

- 2000 – 2011: From boom to bubble to crisis
 - Tax cuts, welfare increases 2000-2008
 - Tax increases, welfare cuts 2008-2011
 - Net impact on financial incentives to work?
- Incentive to take up employment
 - Replacement rate: what % of in-work income is replaced by out-of-work income
- Incentive to progress
 - Marginal effective tax rate

Ireland: Income Tax, PRSI & Levies (as % of GNP)



Tax & Social Insurance as % GDP, 2008



<i>Country</i>	Tax/GDP
Ireland (as % of GDP)	12.3
Ireland (as % of GNP)	14.3
Switzerland	15.8
United States	16.5
United Kingdom	17.5
Netherlands	22.0
Germany	23.5
Austria	24.2
Sweden	25.3
Finland	25.4
Denmark	26.2

Source: OECD



Spot the missing category

“There are known knowns....things we know we know...

There are known unknowns; that is to say we know there are some things we do not know....

But there are also unknown unknowns – the ones we don't know we don't know”

Donald Rumsfeld

Replacement rates: Examples can mislead



- Rent and Mortgage Supplement
- Long-term vs short-term replacement rates
- Family composition of unemployed
- Under 25s get reduced rates of Jobseeker's Allowance

Long-Term vs Short-Term Replacement Rates



- OECD *Benefits and Wages* report that for Ireland long-term RRs are *higher* than short-term RRs
- Short-term=Social insurance (no RMS)
Long-term=Social Assistance (Rent/Mortgage Supp)
- Not a good representation of Irish reality
 - Rent and Mortgage Supplement can be paid with short-term insurance benefits
 - 6 out of 7 jobseekers do not get Rent/Mortgage Supplement

Short-term Replacement Rates, 2007

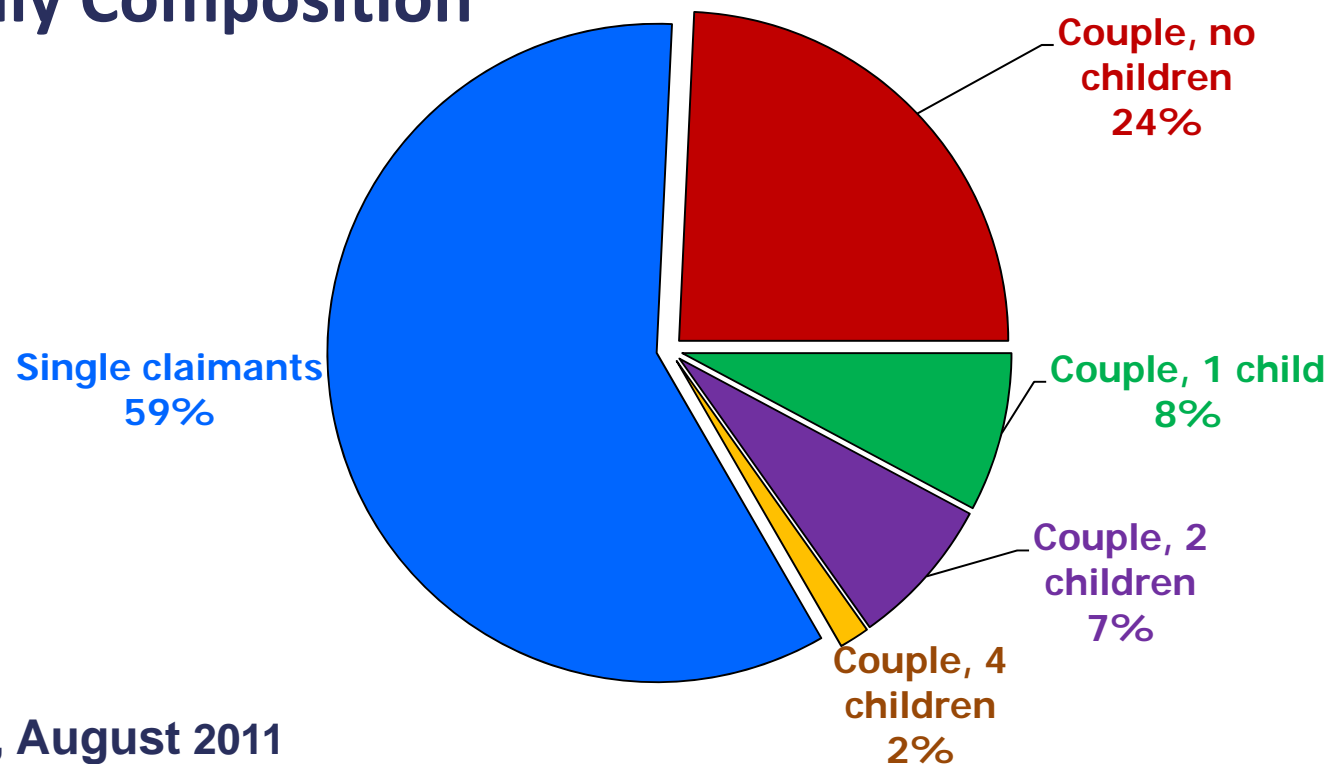


	Short Term
United States	56
United Kingdom	57
Ireland	60
Austria	62
Germany	66
Sweden	71
Denmark	78
Netherlands	78
Switzerland	80

Whose replacement rate?

- Thus far, focused on measures averaged over family types and income levels
- But RRs vary substantially across family type

Family Composition



Short term replacement rate for a **single person, no children, 2009**



	2/3 of average wage		Average wage
Ireland	46	Ireland	33
UK	55	UK	38
Austria	55	Sweden	48
Germany	60	USA	51
USA	60	Austria	55
Norway	67	Denmark	60
Sweden	69	Germany	60
France	70	Norway	65
Netherlands	76	France	67
Switzerland	81	Switzerland	71
Denmark	84	Netherlands	74

Reduced- Rate Jobseeker's Allowance



Age	Maximum Rate 2010
18-21	€100
22-24	€150
25+	€196

Live Register 2010 H2

Age	% of Jobseeker's Allowance Claimants
< 20	5%
20-24	20%
All Ages	100%

Microsimulation approach

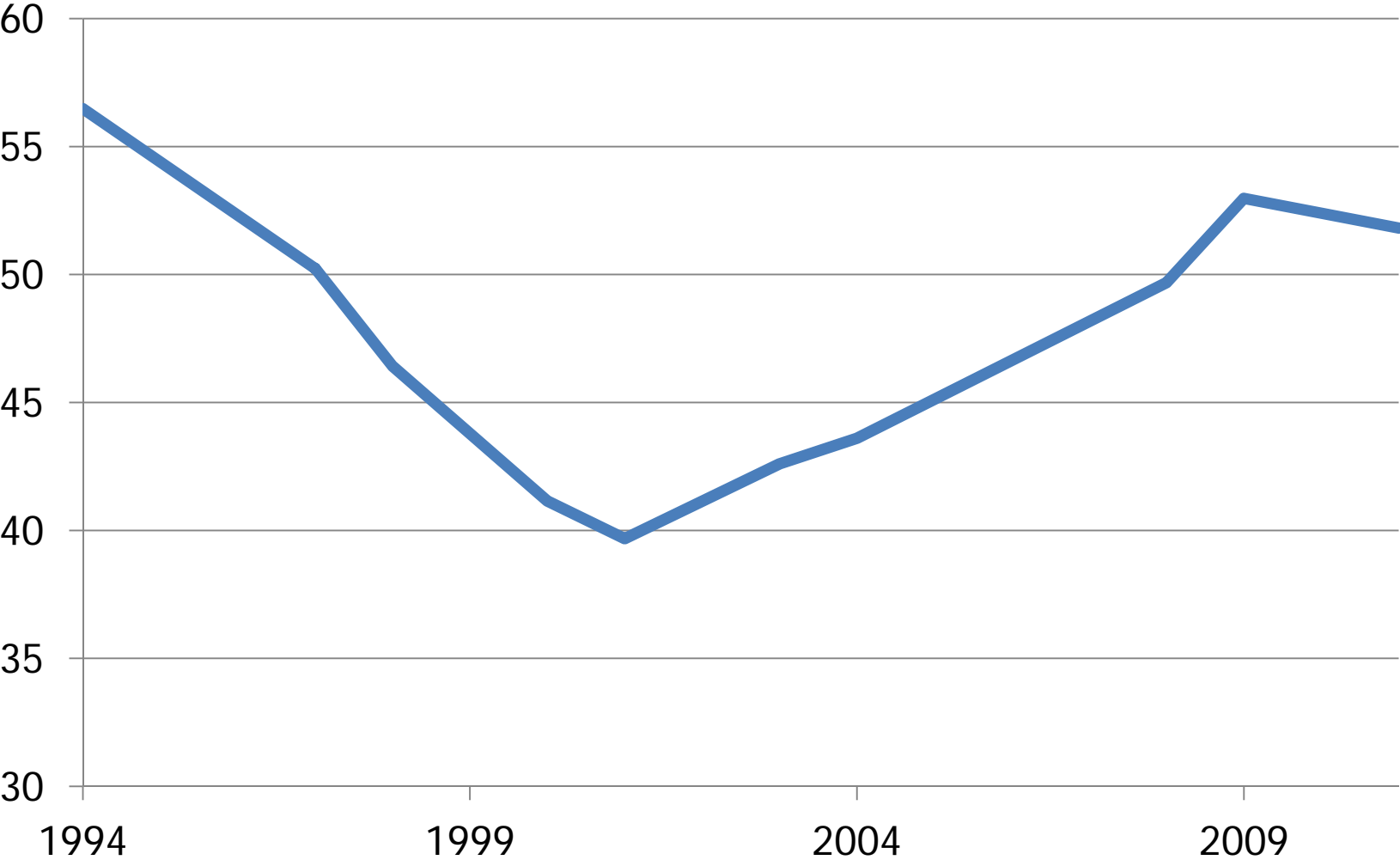
- Takes account of variation across family types
- Family and household circumstances affecting benefits
- Also takes account of differences in potential earnings, based on
 - Educational qualifications
 - Labour market experience
- Differences in potential benefits (e.g., age differentiated payments)
- Provides nationally representative picture

Overview of approach

- Actual 2011 policy is compared with
 - 2000 policy indexed by 52% wage growth
 - 2008 policy indexed by 3.7% wage decline
- Indexation \Rightarrow tax as share of income is held constant
- Overall result
 - 2011 regime gains much more revenue than indexed 2008 regime
 - 2011 policy and indexed 2000 policy
 - Similar net revenue, 2011 higher taxes and welfare

Main welfare payment rate as % of average income

(Working age welfare; median disposable income per adult equivalent)



Replacement rate distribution, 2011

Over	Under	%
	30	18
30	40	19
40	50	21
50	60	19
60	70	4
70	80	6
80	90	8
90	100	2
100		3

High replacement rates 1987, 1994 and 2011: & 2011 under alternative policy regimes



Above	1987	1994	2000 +52%	2008 -3.7%	2011
70%	36	37	13	26	18
80%	23	15	10	19	13
90%	9	6	4	10	4
100%	4	2	1	5	3

Marginal Effective Tax Rates (METRs)

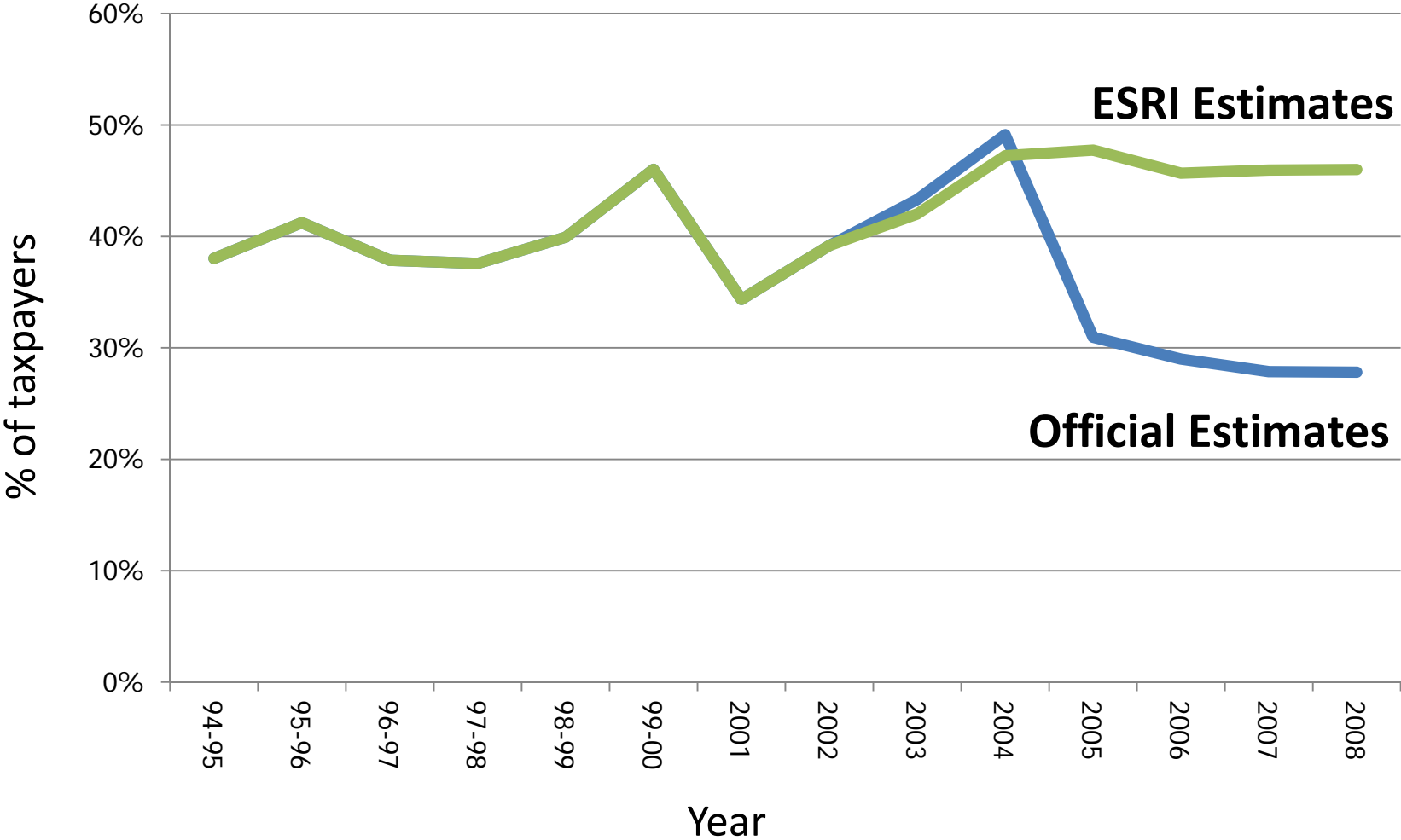


- Amount of tax payable on an additional unit of income earned
 - Incorporates taxes, levies, social insurance and the withdrawal of social welfare payments.
- Measures the financial incentive to progress in the labour market/increase earnings:
 - Increase in work hours
 - Increase in work effort (promotion)
- The lower the METR, the stronger the financial incentive to progress

Existing statistics

- Drawbacks of official measures
 - Statistics produced are for marginal income tax rate only
 - Do not take account of :
 - Levies, PRSI, USC
 - Welfare withdrawal
 - Definitional change post Budget 2007

% of taxpayers facing top tax rate





Microsimulation Analysis I

- Data: Survey on Income & Living Conditions
 - 2008 data updated and reweighted to represent 2011 situation
- SWITCH tax-benefit model
- Policies compared:
 - 2000 (indexed in line with 52% increase in earnings)
 - 2008 (indexed in line with a 3.7% decline in earnings)
 - 2011
- The Margin
 - Additional €100 per week



Microsimulation Analysis II

- Social Welfare take-up:
 - Full take-up of all benefits assumed, except FIS which is assumed to be 33%
- Analysis includes those:
 - Aged 18-65
 - In employment (excludes self-employed, farmers and apprentices)

Distribution of METRs



	2000 Policy	2008 Policy	2011 Policy
<i>METR (%)</i>	%	%	%
≤ 20	10	⇒ 17	9
>20, ≤ 30	⇒ 33	27	13
>30, ≤ 40	4	6	⇒ 26
>40, ≤ 50	⇒ 34	42	14
>50, ≤ 60	13	2	⇒ 31
Over 60	7	6	8
All	100	100	100

Changes in METRs between policies

METR (%)		2000 Indexed to 2011 Policy	2008 Indexed to 2011 Policy
>	≤	(%)	(%)
	-10		2
-10	-5		9
-5	-2		1
-2	2		4
2	5		10
5	10		62
10			14
Total			100

Changes in METRs between policies

METR (%)		2000 Indexed to 2011 Policy	2008 Indexed to 2011 Policy
>	≤	(%)	(%)
	-10	13	2
-10	-5	5	9
-5	-2	1	1
-2	2	15	4
2	5	26	10
5	10	23	62
10		17	14
Total		100	100

Key Drivers of METRs

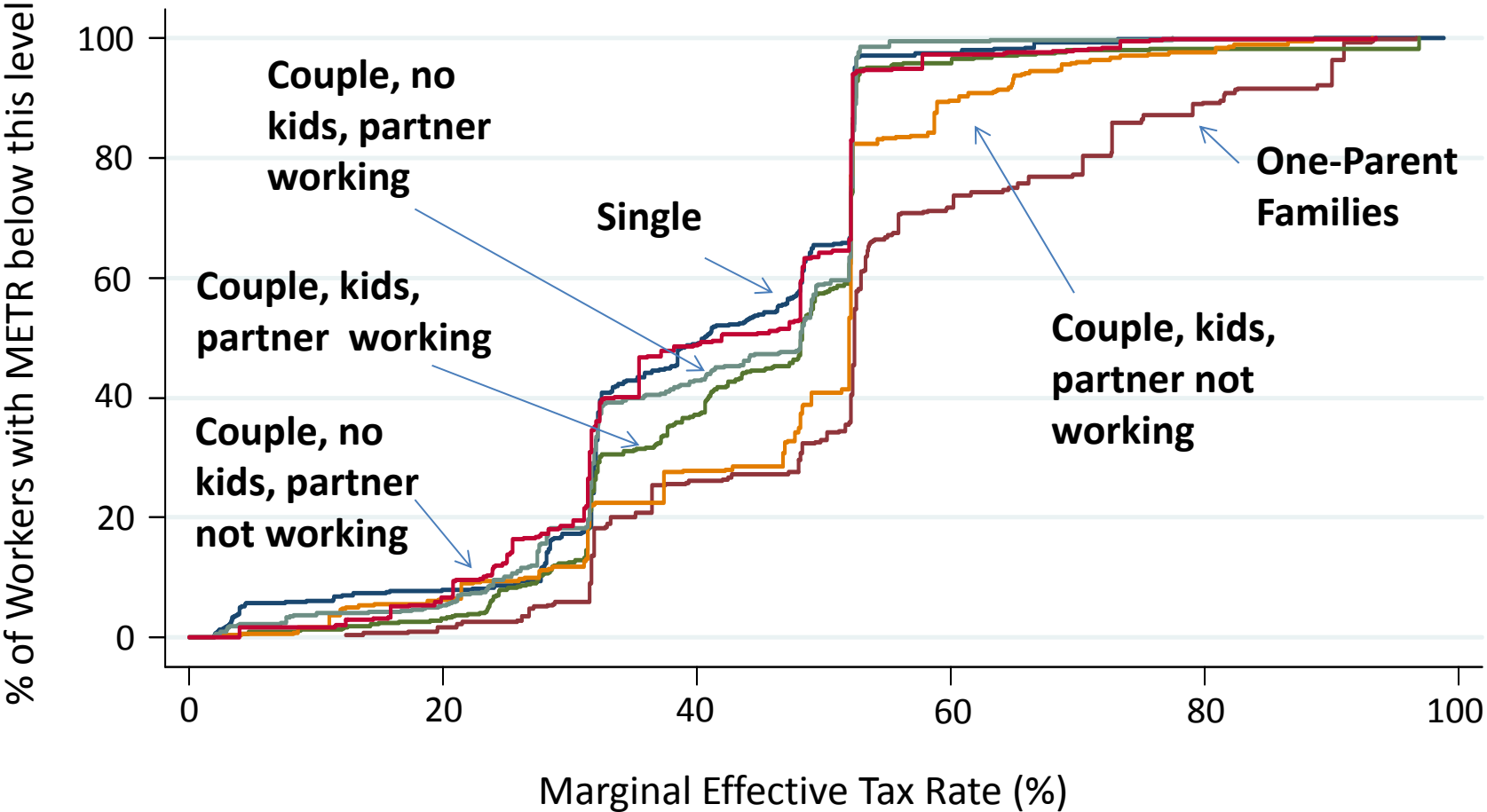
- METRs above 60%: withdrawal of welfare involved (along with tax/SI in some cases)
 - Many cases involve withdrawal of welfare income of spouse/partner (loss of IQA, CDA etc.)
 - Some key schemes (e.g. FIS, OPFP) *strengthen the incentive to take up paid employment but also raise METRs*
- Levies/USC have been the primary drivers of changes in METRs from 2008 to 2011

Variation in Incentives by Family Type

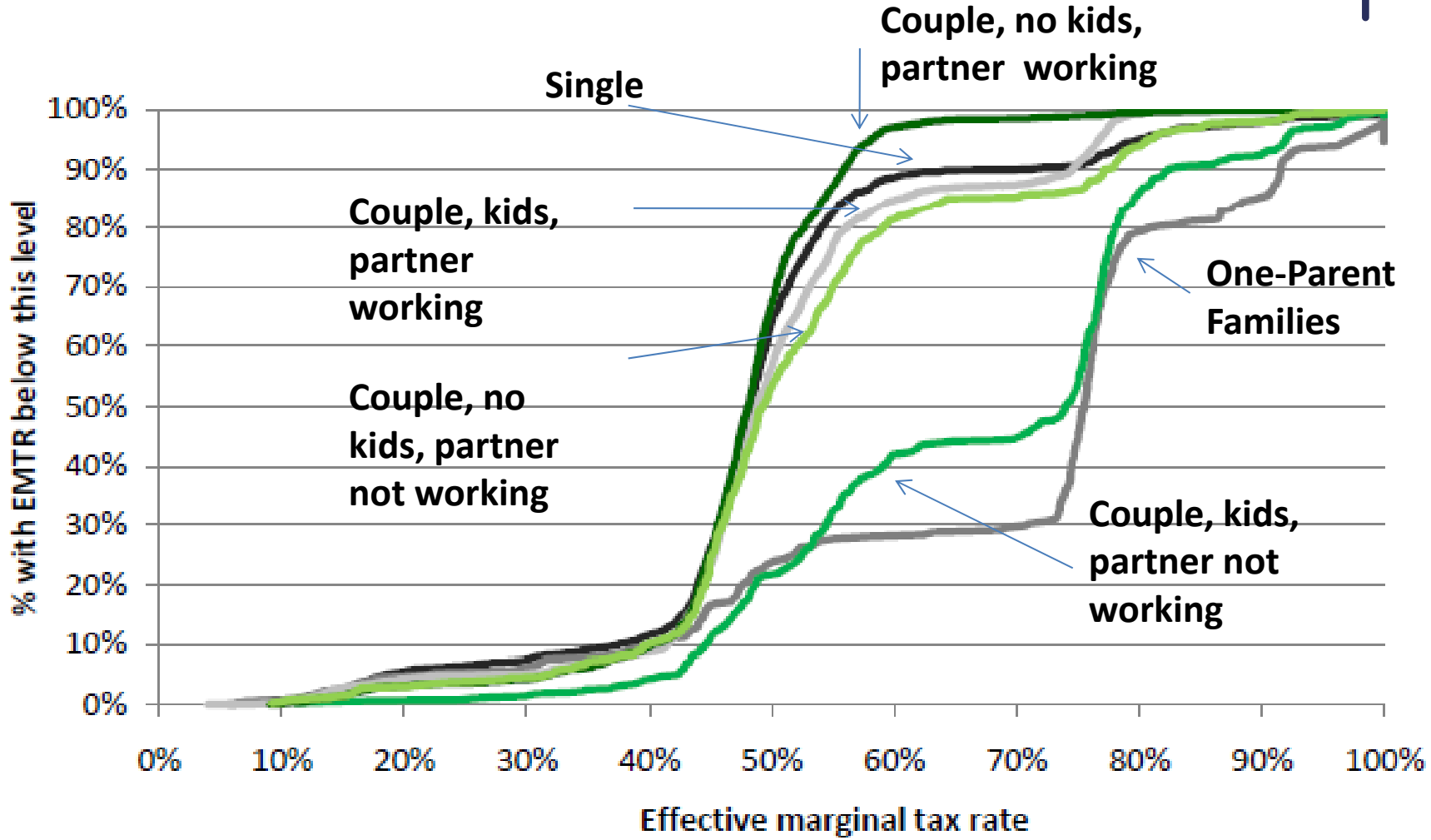


- How do these financial work incentives vary by family type?
- Six types defined:
 - Single
 - Lone-Parent
 - Couple, no children, partner works
 - Couple, no children, partner doesn't work
 - Couple, children, partner works
 - Couple, children, partner doesn't work

Cumulative Distribution of METRs by Family Type, 2011



UK Comparison: Cumulative Distribution of METRs, 2009-2010



Conclusions

- Tax-benefit model needed for a nationally representative picture of work incentives
- Replacement rates
 - Very high rates are very uncommon
 - 2011 distribution is more favourable to incentives than 2008 , 1987 or 1994
 - Somewhat less favourable than in 2000
- Marginal effective tax rates
 - Budgetary changes post-crisis mean that METRs are typically much higher in 2011 than under the 2008 regime
 - Also higher than 2000 policy regime, indexed for wage growth