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Budget 2022

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BUDGET 2022

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ABSTRACT

This Article outlines and assesses changes to the tax and welfare system announced as part of Budget 2022. It first looks at the main taxation measures announced before turning to employment, education and social welfare supports. It then considers the effect of the package of measures as a whole on the incomes of households using representative survey data from the Survey of Incomes and Living Conditions run on SWITCH – the ESRI's tax and benefit microsimulation model – and ITSim – an indirect tax microsimulation model developed jointly by the ESRI and the Department of Finance. The Article concludes with some brief reflections on inflation forecasts and the policy-making process.

1. INTRODUCTION

General Government Expenditure is forecast by the Department of Finance (2021a) to be €105.0 billion in 2022, equivalent to 43.6 per cent of modified Gross National Income (GNI*). This will be financed by €96.7 billion in General Government Revenue (equivalent to 40.2 per cent of GNI*), leaving a General Government Balance deficit of €8.3 billion (3.4 per cent of GNI*) compared to that of €13.3 billion (5.9 per cent of GNI*) in 2021.[2] While the vast bulk of this expenditure, revenue and borrowing arises from the continuation of existing programmes and taxes, changes to the tax and welfare system announced on Budget day are forecast to cost around €1.1 billion.[3]

This Article outlines and assesses these changes, first looking at the main taxation measures announced in Section 2, before turning to employment, education and social welfare supports in Section 3. It then in Section 4 considers the effect of the package of measures as a whole on the incomes of households using representative survey data from the Survey of Incomes and Living Conditions (SILC)

1 Funding from the ESRI's Tax, Welfare and Pensions Research Programme (supported by the Departments of Public Expenditure and Reform, Employment Affairs and Social Protection, Health, Children and Youth Affairs and Finance) is gratefully acknowledged. We are grateful to the CSO for facilitating access to the Survey of Income and Living Conditions (SILC) Research Microdata File used to construct the database for the SWITCH tax-benefit model and to the Irish Social Science Data Archive for facilitating access to the Household Budget Survey used in the ITSim model.

2 See Table 11 of the Budget 2022 Economic and Fiscal Outlook, available at http://budget.gov.ie

3 See Department of Finance (2021b) and Department of Public Expenditure and Reform (2021, pp.107-109).

run on SWITCH – the ESRI's tax and benefit microsimulation model – and ITSim – an indirect tax microsimulation model developed jointly by the ESRI and the Department of Finance. The Article concludes in Section 5 with some brief reflections on some of the challenges facing the government in the coming years.

2. TAXATION MEASURES

Table 1 shows the full year revenue yield or cost of the taxation measures announced in Budget 2022, as estimated by the Department of Finance (2021b). The most expensive measure was the above forecast inflation increases to income tax credits and bands, costing almost €600 million per year. This will see the standard rate band increase by €1,500 per year (e.g. from €35,300 to €36,800 for single taxpayers, 4.2 per cent), and the main (PAYE, personal and earned income) tax credits increase by €50 per year (from €1,650 to €1,700, 3.0 per cent). While the standard-rate band has been raised in some recent Budgets, this marks the first increase in the personal and PAYE tax credits since 2008 and means that the after-income tax purchasing power of those earning enough to pay income tax will rise slightly in real terms, so long as the inflation outturn is similar to forecast levels.[4]

[4] At the time the Budget was announced, the Department of Finance (2021a) forecast HICP inflation of 2.2 per cent in 2022, somewhat below the 2.9 per cent forecast of the Central Bank (2021) and the 2.5 per cent (CPI) forecast in the ESRI Autumn *Quarterly Economic Commentary*.

TABLE 1 2019 YIELD OR COST OF TAX MEASURES ANNOUNCED IN BUDGET 2019

	€ million
Personal income tax measures	
Increases to income tax credits and bands	-597
Extension of sea-going naval personnel tax credit	-0.5
Employer PRSI threshold increase	-12.5
USC	
Increase in 2% rate ceiling	-26
Extension of reduced rate for medical card holders	-72
Bank Levy extended at reduced rate	+87
Introduction, extension or expansion of tax reliefs	
Taxation of International Flight Crew	-12
New tax credit for digital gaming development	-6
Exemption from corporation tax for certain start-ups	-10
Extension and expansion of the Employment Investment Incentive	-10
Extension of stock relief	-8
Extension of Young Trained Farmer (Stamp Duty) Relief	-15
Extension of Help to Buy at 'enhanced' rates	-175
Extension of pre-letting expenses for landlords	-3
Income tax disregard for households who sell electricity they generate	-1
Changes to excise duties	
50c increase in duty on pack of cigarettes	+56
Increase in carbon tax to €41.00 per tonne	+148
VRT	
Revised rates and extension of benefit-in-kind relief for electric vehicles	+82

Source: Department of Finance, 'Budget 2022 Tax Policy Changes' document, available at https://www.gov.ie/en/publication/7e491-taxation-measures/.
Note: Full year cost or yield. Excludes certain measures with unknown or nil cost/yield.

However, given forecast growth in compensation per employee of 4.8 per cent (Central Bank of Ireland, 2021), the increase in income tax credits and bands is unlikely to be sufficient to offset 'fiscal drag': the exposure of a greater share of aggregate earnings to tax because of slower growth in credits and bands than earnings, which – all else equal – leads to a larger share of national income taken in tax. In addition, 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. Exceptions to this were the ceiling for the 8.8 per cent rate of employer PRSI (which was increased by €12 per week – 3.0 per cent – at a cost of €12.5 million) and the 2 per cent rate of USC (which was increased by €608 per year – 2.9 per cent – at a cost of €26 million).

While the reason given for the former increase was that the Low Pay Commission had recommended ensuring 'that the increase in the hourly minimum wage does not lead to work disincentives for workers' (Department of Finance, 2021b, p.14), the change simply moves the point at which a small rise in weekly earnings can lead to a discontinuous jump in employer PRSI contributions. For example, given the new minimum wage of €10.50 per hour the changes mean that PRSI contributions for a worker on the minimum wage jump discontinuously by around €9 per week (€470 per year) if they go from working 39 to 40 hours per week instead of from 38 to 39. Indeed, the 2021 Low Pay Commission's report published on budget day[5] recommended a far more comprehensive reform of PRSI to eliminate the discontinuities in the employee and employer schedules, which research has shown can lead part-time workers in particular to earn less than they otherwise would (Adam et al., 2021; Hargaden, 2020).

The other significant change announced to taxes on personal income was that the exemption of medical card holders from the higher (4.5 per cent and 8 per cent) rates of USC would be extended for another year at a cost of €72 million. Similarly, the Bank Levy – introduced in 2003 and charged on the amount of Deposit Interest Retention Tax (DIRT) paid by eligible financial institutions in a past 'base' year – will be extended for another year, though raising €87 million instead of €150 million as previously.[6]

The introduction, expansion and extension of an assortment of tax reliefs was also announced by the Minister for Finance. These have a combined estimated cost of €250 million, with the single most expensive measure the extension for another year of the Help to Buy scheme at a cost of €175 million. This provides a refund of income tax and DIRT paid in the previous four years to first-time owner-occupiers taking out a mortgage to self-build or buy a new-build residential property. Introduced as a temporary measure in 2016, the relief has been expanded and repeatedly extended at a cost of more than €500 million to date (compared to an anticipated cost of €130 million) despite concerns that it is poorly targeted towards its stated aims and likely to fuel house price growth.[7]

The tendency for tax reliefs to cost significantly more than anticipated when introduced highlights the importance of regular and rigorous review. However, as highlighted by Roantree and Kakoulidou (2021), evaluations are routinely based almost exclusively on responses to surveys of beneficiaries gathered through a

5 See Low Pay Commission (2021), available at https://www.gov.ie/en/publication/a8e07-low-pay-commission-annual-report-2021/ [accessed 02/11/2021].

6 The rationale given for this was that the levy would not apply to Ulster Bank Ireland DAC and KBC Bank Ireland plc 'due to the fact that they are exiting the market' (Department of Finance, 2021, p.13).

7 See, for example, Kakoulidou and Roantree (2021), O'Toole and Slaymaker (2021), and Parliamentary Budget Office (2019).

non-representative public consultation process, a methodology which cannot deliver credible evidence on their impact. They argue for the development of greater expertise in the evaluation of tax reliefs, potentially through the establishment of a dedicated tax relief evaluation unit within the Irish Government Economic and Evaluation Service or the Parliamentary Budget Office.

Alongside these tax reliefs, the Minister for Finance also announced he would introduce a new tax on land zoned suitable for residential development, but which has not been developed for housing. The stated aim of this Zoned Land Tax (ZLT) is 'to increase the supply of residential accommodation, rather than to raise revenue', and will replace a vacant site levy which local authorities have struggled to implement.[8] Research suggests that recurrent land taxes can help increase housing supply by encouraging owners to develop or dispose of underutilised sites.[9] They can also act to deter sprawl (Banzhaf and Lavery, 2010) and – through capitalisation into the price of zoned land – capture a share of the windfall gains that up-zoning or obtaining planning permission bestows upon landowners without – as is the case with 'betterment' or development taxes – encouraging landowners to delay development in the hope that the tax is abolished.[10]

However, the effectiveness of the ZLT in achieving these outcomes depends heavily on the details of what is and what is not included within its scope. The Finance Bill currently being debated by the Houses of the Oireachtas specifies that the ZLT will only apply to land zoned for residential (or mixed-residential) use that:

> *it is reasonable to consider may have access, or be connected, to public infrastructure and facilities, including roads and footpaths, public lighting, foul sewer drainage, surface water drainage and water supply, necessary for dwellings to be developed and with sufficient service capacity available for such development.*[11]

This restriction has the potential to create an incentive for owners of residential zoned land to defer seeking connection of their sites to public infrastructure and facilities in order to avoid the ZLT, particularly if there is a prospect of the tax being abolished by a future government.

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8 As noted by the Parliamentary Budget Office (2020), 'of 31 local authorities, just 17 had active registers (i.e. with listed sites) with assigned market valuations' by the end of 2019, while of these only four had collected any payment.

9 See Morley et al. (2015) for an accessible overview of some of the research on this topic.

10 See the discussion in Mirrlees et al. (2011, pp.370-373).

11 See pp.163-166 of the Finance Bill 2021, available at https://www.gov.ie/en/press-release/56823-minister-donohoe-publishes-finance-bill-2021-underpinning-measures-to-support-economy-and-society-in-budget-2022/.

In addition, the Finance Bill specifies that the ZLT will not apply to land 'that it is reasonable to consider is being used to provide services to residents of adjacent residential areas' or:

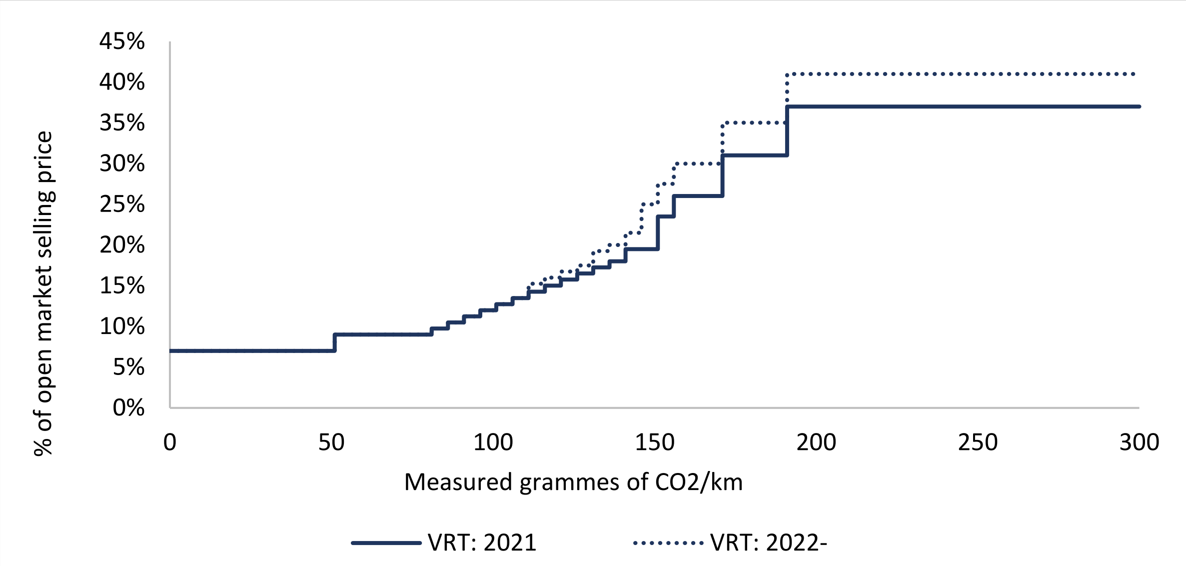
> *that it is reasonable to consider is required for, or is integral to, occupation by … social or community infrastructure and facilities, including educational or healthcare infrastructure and facilities; transport facilities and infrastructure; energy infrastructure and facilities; telecommunications infrastructure and facilities; water and wastewater infrastructure and facilities; waste management and disposal infrastructure; recreational infrastructure, including sports facilities and playgrounds.*

While such exemptions may have a genuine underlying policy rationale, they nevertheless also have the potential to undermine the effectiveness of the tax in achieving its stated aim by, for example, enabling landowners to avoid the ZLT by using a site as a temporary car park, allotment or playing pitch.

Budget 2022 also saw changes to a number of indirect taxes announced. Although most excise duties were frozen in cash terms (amounting to an effective cut given rising prices), Tobacco Products Tax was increased by the equivalent of €0.50 on a pack of 20 cigarettes. Increases in the tax on tobacco are likely to be effective at furthering deterring people – particularly younger people – from smoking as much or at all, but they can also lead some to purchase tobacco products abroad or illegally (Friedson et al., 2021; Kennedy et al., 2015). For these reasons, Revenue have historically placed a wide range around their central estimate of the yield from raising Tobacco Products Tax, forecast to be €56 million per year for the increase announced in Budget 2022 but subject to a large degree of uncertainty.

For the second year in a row there was an increase in the rates of VRT applied to high CO2 emission cars. This is forecast to raise €82 million per year but is also intended to encourage consumers to purchase smaller, less-emitting cars. Figure 1 illustrates this, plotting the rate of VRT charged on the estimated value of a vehicle with a given level of emissions in 2021 and from 1 January 2022. This shows that the VRT levied on vehicles emitting more than 110 grammes of CO2 per kilometre will increase, with proportionally larger increases in tax rates for vehicles of between 130 and 170 grammes.

FIGURE 1 CHANGES TO VEHICLE REGISTRATION TAX (VRT)



Source: Authors' calculations based on Department of Finance (2021b).

While there is a coherent rationale for using upfront taxes on newly registered cars to incentivise behavioural change among consumers, Adam and Stroud (2019, p.227) argue such a policy is likely to be more effective if combined with a scrappage scheme that similarly depends on emissions. Such a combination of tax and subsidy would be neutral for someone replacing an old car with a new car of the same emissions level, but encourage people with old, high-emitting cars to replace them with cleaner, new models.

A final change to indirect taxes was the increase to the carbon tax from €33.50 to €41.00 per tonne of carbon dioxide emitted.[12] A carbon tax is the most efficient way of incentivising carbon abatement; that is, of achieving a given reduction in carbon emissions at the lowest economic cost, with a large literature finding that such taxes would reduce emissions in Ireland with little wider economic costs (e.g. FitzGerald and McCoy, 1992; FitzGerald et al., 2002; Bergin et al., 2004; di Cosmo and Hyland, 2013; Conefrey et al., 2013; de Bruin and Yakut, 2018; 2019).[13] Even though few broad-based carbon taxes have been in place for long, there is now also substantial evidence from ex-post evaluations that they are highly effective at reducing emissions, particularly from transport (see, for example, Andersson, 2019; Runst and Thonipara, 2020; Metcalf and Stock, 2020; Best et al., 2020).

12 This and the following paragraph draw on the discussion in O'Malley et al. (2020).

13 This goes back as far as Baumol and Oates (1971) and Weitzman (1974). See Metcalf (2019) for an accessible summary of this literature and discussion of arguments in favour of a carbon tax over cap and trade schemes, namely less administrative complexity, damaging price volatility and potential for adverse policy interactions.

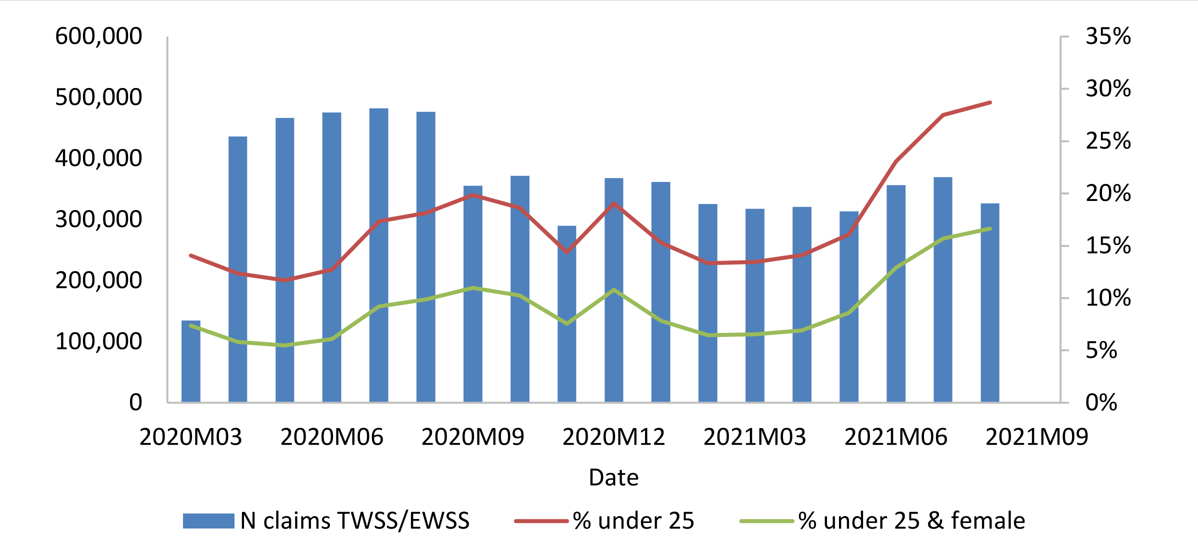
However, there is also widespread recognition that carbon taxes can have distributional consequences that policymakers may be concerned about. This arises largely because certain groups – especially lower-income households – spend a disproportionate share of their incomes on carbon-intensive goods, in particular heating fuel. As a result, a carbon tax can have a regressive impact in the absence of an accompanying package of compensation measures. As discussed in the next section, Budget 2022 also saw the announcement of measures to compensate low-income households for such impacts by increasing certain welfare payments (as well as income tax credits and bands, discussed above). One should therefore consider the impact of the carbon tax increase on households' incomes in conjunction with other changes to the tax and welfare system, as we go on to do in Section 4.

3. CHANGES TO EMPLOYMENT, EDUCATION AND SOCIAL WELFARE SUPPORTS

The most significant announcement in Budget 2022 in cost terms was changes to the Employment Wage Subsidy Scheme (EWSS). This was introduced in September 2020 and replaced the Temporary Wage Subsidy Scheme (TWSS), with the aim of both being to provide support to those affected by the COVID-19 pandemic while maintaining a link between employers and employees. While the precise structure has varied over time, broadly speaking the schemes have operated as a subsidy to firms experiencing a decline in turnover based on the number and earnings of eligible employees along with a reduced rate of employer PRSI on the earnings of these employees. €8.6 billion has been paid through the TWSS and EWSS to date, though the ultimate cost to the Exchequer depends on the extent to which the scheme was paid to firms who would have continued to operate and pay their employees even if the subsidy was never introduced; something on which there is currently no good evidence.

The Minister announced the EWSS would continue at the current rates for October and November before being cut in December then closed to new entrants from 1 January 2022. Remaining claims will be paid at a reduced rate per eligible employee – and with the standard rates of employer PRSI applied – in March and April before the scheme ceases to operate entirely in May.

FIGURE 2 CLAIMS FOR AND COMPOSITION OF TWSS/EWSS



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2022 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2022 income levels.

Determining how long to continue operating the EWSS for is challenging. On the one hand, maintaining the subsidy would mean supporting both employment which would exist even if the subsidy was no longer in place (a deadweight cost) and employment which is no longer viable in the long term (where employees should be given the opportunity to re-train in other roles). On the other hand, withdrawing it too early could lead some firms to fail who would – had the pandemic never occurred – have continued to be viable. An additional consideration is that the EWSS has increasingly come to support younger, female workers. This is shown in Figure 2, which plots the number of eligible employees covered by the EWSS and TWSS along with the share of these employees who are under 25 (in red) and under 25 and female (in green). These shares have risen in recent months to almost 30 per cent and 20 per cent respectively, much higher than the share of total employment these groups make up. This suggests that such workers could be disproportionately affected by the withdrawal of the EWSS, particularly given the recent announcement of additional public health restrictions affecting the hospitality industry in which a large number of younger workers are employed (Roantree et al., 2021). Indeed, the reimposition of restrictions raises the question whether there is a case for delaying the closure of the EWSS to new applicants in January as planned.

There was also an increase in generosity announced to the main student maintenance grants for the first time since 2012. In addition to increasing rates by €200 per year (an increase of 6 per cent in the full non-adjacent rate, currently set at €3,025 per year), the threshold which family income must be below in order to qualify for a grant will rise by €1,000 per year (from €39,875 for the full non-adjacent rate for someone from a family with 1-3 dependent children) and the distance someone must normally live from the institution they are going to attend to avail of the non-adjacent rate reduced from 45km to 30km. However, these are ultimately quite small changes to a system whose coverage – as Keane et al. (2021) note – has declined in recent years 'because income thresholds for the grant have tended to remain static for long periods despite incomes rising'. Indeed, Keane et al. point out that the full non-adjacent maintenance grant currently amounts to 29 per cent of even the €112.40 per week 'young' jobseeker's allowance rate, compared to about the same level of the full jobseeker's allowance rate in the early 1970s. Given the importance of financial support for both access to and retention in post-secondary education (Mooney et al., 2010), there is good reason to think that more radical reform of student grants may be needed to help achieve the Government's objectives in this area.

Another area that saw supports increased was childcare. An extension to the duration of parent's leave and Parent's Benefit to seven weeks from five weeks was announced. There was also a substantial increase in funding for the providers of registered childcare – accounting for around half of all childcare in Ireland – who commit to freezing their prices. There were also changes to the National Childcare Scheme (NCS), which subsidises registered childcare, with the Universal Subsidy – which current pays 50c per hour for children under three – extended to cover children up to age 15 and an increase in the hours covered by the NCS for children in school or pre-school. Wider eligibility for the Universal Subsidy is likely to benefit higher income households who are not eligible for the income-assessed component of the subsidy while expanding the hours available to pre-school and school children is likely to benefit more low income households. The rate of payment of the NCS was frozen in cash terms as were the income limits for eligibility for the income-assessed component of the subsidy. Given forecast wage growth for 2022, some families are therefore likely to lose their eligibility for the income-assessed subsidy.

Finally, Budget 2022 saw increases to most social welfare payments. There were significant above-forecast inflation increases in the Fuel Allowance (a seasonal supplementary support payable to long-term recipients of certain social welfare payments, increased by 18 per cent or €5 per week) and the additional payments made to those living alone or with dependent children in receipt of social welfare payments (the Living Alone Increase and Increases for Qualified Children, which rose by 16 per cent and c.6 per cent respectively). Recipients of these benefits are more likely to be at risk of poverty and to spend a high share of their income on fuel than social welfare recipients living with other adults, making the measures well-targeted at mitigating – and potentially offsetting – the adverse impacts of the carbon tax increase on vulnerable low-income households (Bercholz and Roantree, 2019; O'Malley et al., 2020). There were smaller increases in the main social welfare payments for working-age couples without children, with the €5 per week rise in personal rates and proportional increases for dependent adults corresponding to a 2.5 per cent rise: just above the forecast rate of inflation.

However, the decision to also announce a €5 per week increase in the maximum rate of the contributory and non-contributory State Pension amounts to a below inflation rise (real cut) for retirees living with another adult. This is because the maximum personal rate of the contributory (non-contributory) State Pension is currently set at €248.30 (€237) per week for those aged 66-79 compared to €203 per week for most working-age payments, making the €5 per week increase equivalent to a 2.0 per cent (2.1 per cent) increase compared to 2.5 per cent for working-age payments. Similarly, the €10 per week increase in the income limits for Working Families Payment corresponds to an at most 1.8 per cent rise in payments for many low-income working-age families with children, again below the forecast rate of inflation. The combined effect of these decisions was – as we will see in the next section – to protect the incomes of some households but not others from both inflation and increases to indirect taxes.

4. IMPACT OF MEASURES ON HOUSEHOLD INCOMES

We use SWITCH – the ESRI's tax benefit microsimulation model – and ITSim – an indirect tax microsimulation tool jointly developed by researchers at the ESRI and the Department of Finance – to assess the combined impact of taxation and welfare policy changes on households' incomes. SWITCH is run on data from the 2019 Survey of Income and Living Conditions (SILC), the primary source of information on household incomes collected annually by the CSO. The scale, depth and diversity of this survey allows it to provide an overall picture of the impact of the policy changes on Irish households, which cannot be gained from selected example cases. ITSim estimates the indirect taxes (VAT and excise duties, including carbon taxes) paid by Irish households on the basis of their reported expenditure, collected by the CSO's nationally representative Household Budget Survey (HBS) in 2015-2016.[14]

Given the substantial impact of the COVID-19 pandemic on employment, we first adjust the 2019 data in order to be representative of the 2021 population in terms

[14] Incomes are uprated to 2022 levels using a variety of earnings, output and price growth indices and expenditures are uprated to 2022 levels using price growth indices.

of unemployment rates. A proportion of workers in each industry are assumed to have either lost their job or to have been put on the Employment Wage Subsidy Scheme (EWSS). The number of individuals to either lose their job or receive the EWSS is calibrated from publicly available data on the number of people in receipt of the Pandemic Unemployment Payment (PUP) and the EWSS. Both calibrations are done using the latest available numbers at the time of the Budget. EWSS figures are calibrated to August 2021[15] while PUP figures are calibrated to October 2021.[16] Both calibrations account for the industry and age breakdown of recipients of either scheme.[17]

We then use SWITCH to calculate households' social welfare entitlements, tax liabilities and net incomes under the system that will apply next year (including the changes announced in the Budget) and under a counterfactual inflation-indexed system. This increases the tax credits, bands, thresholds and welfare payments currently in place by forecast inflation of 2.2 per cent[18] between 2021 and 2022. Doing so provides a benchmark that holds welfare payments, tax credits and thresholds constant in real terms and so can be considered an 'inflation proofed' Budget (at least to the extent that inflation transpires to be no higher than forecast, a topic we return to in our conclusion).[19]

Figure 3 illustrates the impact of Budget 2022 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 and changes to the National Childcare Scheme are shown separately with the total effect represented by the solid green line. Compared to an inflation-indexed system, we estimate that direct tax and benefit measures will result in small gains for most households. On average, the gain is 0.2 per cent of household disposable income but there is some variation across the income distribution.

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15 COVID-19 Support Schemes Statistics Update 09 September 2021 (revenue.ie).

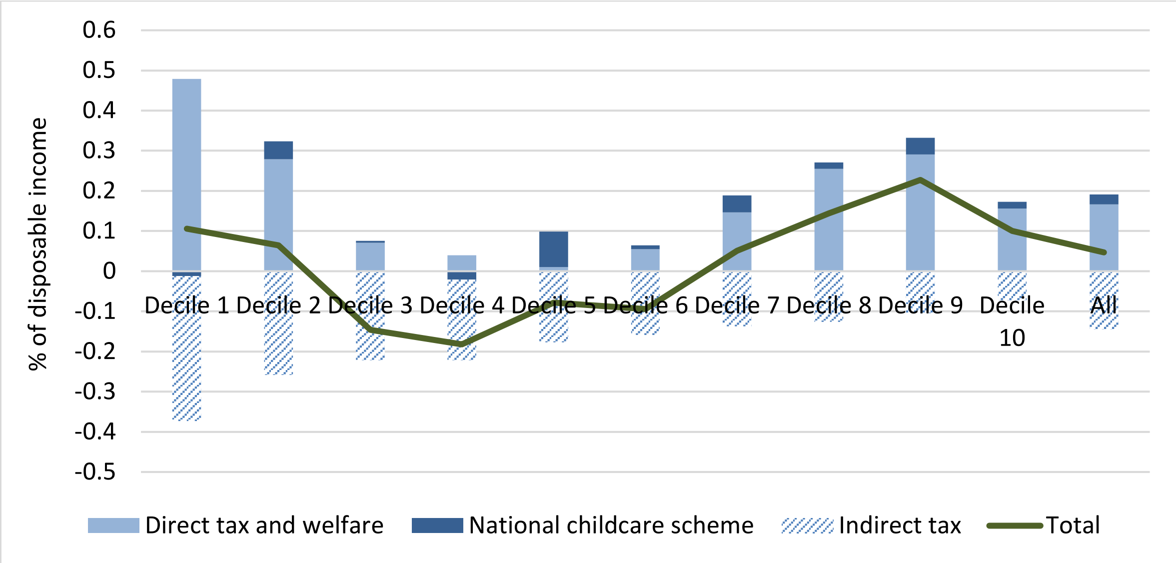
16 https://www.gov.ie/pdf/?file=https://assets.gov.ie/200907/51f7e7e4-8713-48ea-8919-4744e9b00d22.pdf#page=null

17 COVID-19 Adjusted Monthly Unemployment Estimates by Age Group, Lower and Upper Bound, Month, Statistic and Sex https://statbank.cso.ie/px/pxeirestat/Statire/SelectVarVal/Define.asp?maintable=MUM02&PLanguage=0

18 As per the Department of Finance (2021a) forecast available at the time of the Budget.

19 While these rules could alternatively be indexed by forecast wage growth to provide a more distributionally neutral benchmark, no such forecast was available given the uncertainty associated with the ongoing pandemic. See Callan et al. (2019) for a discussion of indexation options and the associated issues they raise.

FIGURE 3 DISTRIBUTIONAL EFFECT OF BUDGET 2022



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2022 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2022 income levels.

Notes: Deciles are based on equivalised household income, using CSO national equivalence scales.

Lower income households benefit relatively more from above-inflation increases to some welfare payments. Higher income households benefit more from the increased tax band and credits. Middle income deciles, which contain many earners who do not pay tax or do not pay the top rate of tax benefit less from taxation measures. This results in a U-shaped pattern of gains with lower and higher income households gaining more than middle income households.

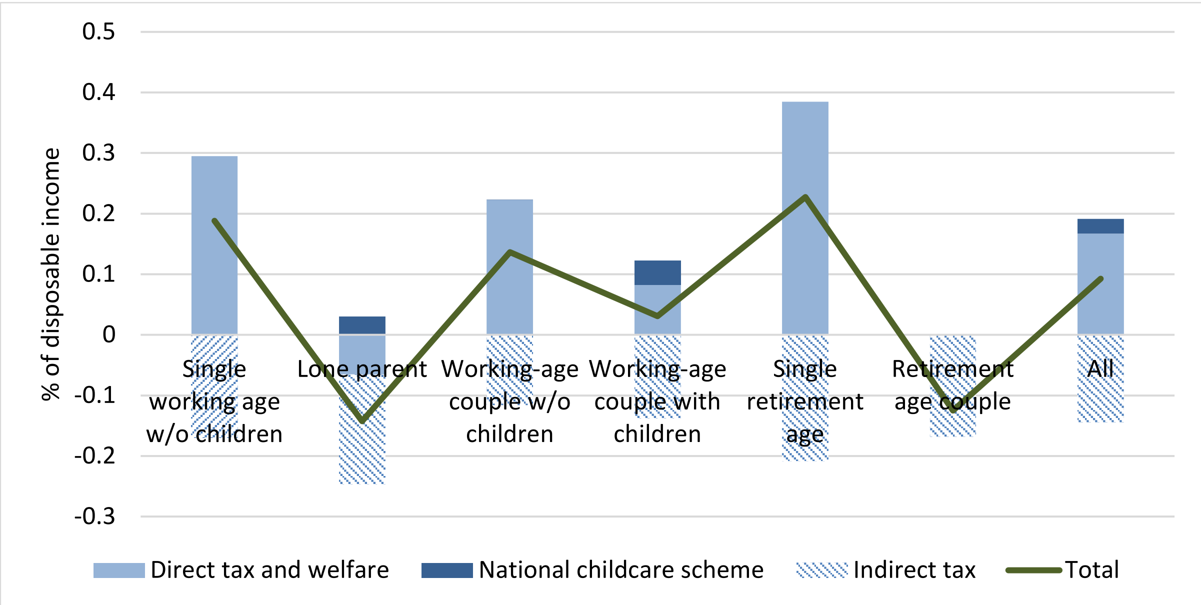
Compared to an inflation indexed system, indirect tax measures decrease household disposable income by 0.15 per cent on average with lower income households experiencing slightly higher income losses than higher income households. Reforms to the National Childcare Scheme result in very small changes to disposable income across the income distribution. Some deciles experience small gains as they benefit from the extension of the Universal Subsidy or increased hours of subsidised childcare. Some deciles experience small losses due to the freezing in cash terms of the income bands for eligibility to the NCS.

The overall effect of Budget 2022 compared to an inflation-indexed system is to leave average disposable incomes virtually unchanged. There are small gains on average in the lower two deciles and upper four deciles which are counteracted by small losses in the middle four deciles. As a note of caution, these estimated effects are very small as a proportion of disposable income (between -0.2 per cent and +0.2 per cent) and there is uncertainty inherent in any such summary measures.

Our main take-away, therefore, is that Budget 2022 largely maintains disposable income, on average, compared to an inflation-indexed system.

Figure 4 shows the estimated effect of Budget 2022 by household type. Most households are estimated to experience small income gains, compared to price-adjusted policies. Two exceptions are lone parents and retirement age couples. In each case, direct tax and welfare measures do not fully compensate these household types for changes to indirect taxation. In each case, this can be explained by below average increase to particular benefits. Lone parents are more likely to receive child benefit, which was frozen in nominal terms, compared to other household types. This results in a real decrease in disposable income for this group. Retirement age couples experience real income losses as the contributory pension increase is below forecast inflation. This group benefits less from fuel allowance and does not receive the living alone allowance, both of which increased by more than forecast inflation, leading to income gains for single retired households.

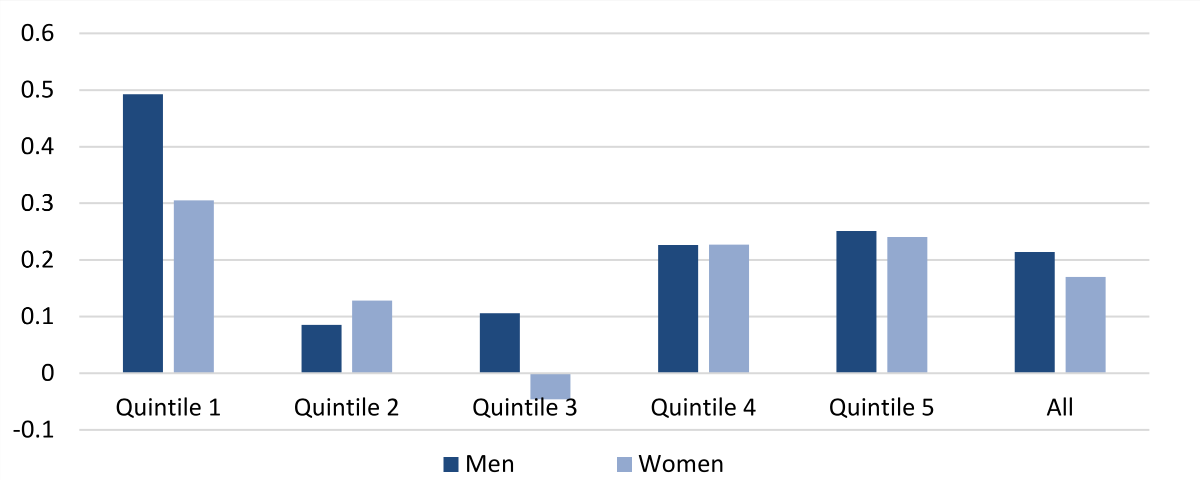
FIGURE 4 THE EFFECT OF BUDGET 2022 BY HOUSEHOLD TYPE



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2022 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2022 income levels.

Figure 5 shows the estimated effect of the direct tax and welfare measures announced in Budget 2022 by gender, under the assumption that income is split evenly between members of a couple. We estimate that, compared to a price-adjusted budget, men gain slightly more as a result of Budget 2022 than women. These differences are more pronounced in the lower half of the income distribution and reflect the fact that women are more likely than men to be lone parents and, due to lower average labour market attachment, less likely than men to benefit from increases to tax bands and credits.

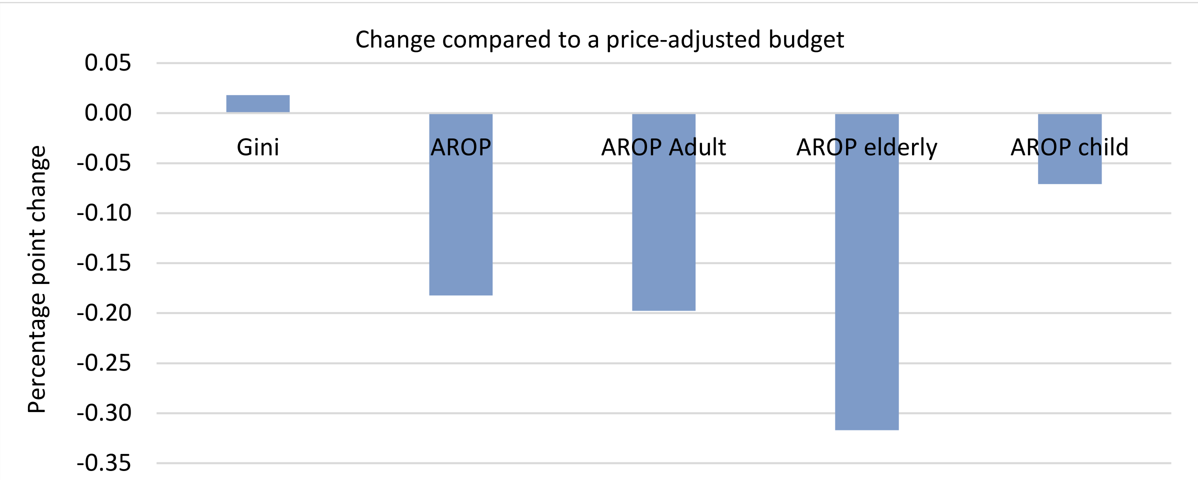
FIGURE 5 THE EFFECT OF BUDGET 2022 BY GENDER



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2022 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2022 income levels.
Note: Income is assumed to be fully shared between members of a couple.

Figure 6 shows the estimated effect of Budget 2022 on inequality and at risk of poverty (AROP) measures. Income inequality, measured by the Gini index, is stable compared to an inflation-indexed system. There are small decreases to the AROP rate, reflecting the targeted measures used to insulate lower income households from indirect tax increases. This decrease is slightly higher for elderly households, who already have a relatively low AROP rate compared to working age adults and children.

FIGURE 6 THE EFFECT OF BUDGET 2022 ON INEQUALITY AND POVERTY



Source: Authors' calculations using ITSim linked to the 2015-2016 Household Budget Survey uprated to 2022 prices, and SWITCH run on 2019 Survey of Income and Living Conditions data, uprated to 2022 income levels.
Note: The poverty rate is calculated based on a poverty line equal to 60 per cent of median equivalised disposable income. The CSO equivalence scale is used. Working age defined as aged 18-65 and children as those under age 18.

5. CONCLUSIONS

Budget 2022 contained some well-targeted reforms with clear objectives. For example, above inflation increases to the Living Alone and Qualified Child payments are effective ways to tackle poverty and to compensate low-income households for indirect tax increases. Similarly, raising tax on carbon and cars is an effective way to cut emissions.

However, our analysis reveals some inconsistencies in how tax and welfare parameters are changed. It seems unlikely that it was the Government's intention to announce some real increases and some real cuts to the main social welfare payments. Yet this was the effect of announcing the increases as an easy to communicate but undifferentiated €5 per week rise in maximum personal rates. Such increases have the effect of changing the connection between levels of payments and adequacy in an ad-hoc way that generates uncertainty for and inequality across claimants. Similarly, it's not clear why the Government chose only to raise income tax credits and bands but leave most PRSI and USC thresholds frozen in cash terms (a real tax increase).

A more coherent way to approach the setting of welfare payment rates and tax thresholds would be for a Government to set out an overarching strategy for the tax and welfare system in its first few months in office, with changes announced on Budget Day then directed at achieving this. Such an approach would provide greater certainty to households on how their incomes are likely to evolve – as well as to the public finances – by providing an indication of how much is likely to be needed in the medium-run to fund the Government's tax and welfare package.

Taken together, the tax and welfare measures announced in Budget 2022 will – on the basis of contemporaneous forecasts – compensate most households for rising prices next year. However, below inflation increases to the Working Families Payment and State Pension mean that some low-income working parents and retired couples who do not receive the Fuel Allowance will see their disposable incomes eroded by inflation, even on current forecasts. In addition, given the disruption to international supply chains and rising wholesale energy prices, it is possible that the outturn for inflation will be higher than forecast. In this case, the increases to some targeted welfare measures like the Fuel Allowance, Living Alone and Qualified Child payments may not be enough to insulate low-income households from rising prices.

There is also uncertainty around the evolving public health situation. The identification of a new – potentially more transmissible – variant of COVID-19 has led to the reintroduction of restrictions on hospitality, leisure and entertainment activities. This raises the question of whether there is a case for expanding – or delaying the closure of – supports to affected workers and firms which had already or were due to expire in the coming months, something the Government was considering as this Article was going to print. As discussed above, determining how long to keep such supports in place is a challenging question to which there is no obvious correct answer. However, the longer such supports remain in place, the more important it is to address issues around their design. For example, Keane et al. (2021) highlight the potential for the cliff-edge withdrawal of the PUP to inhibit employees from returning to work, something which could be mitigated by allowing returning workers to retain some of their payment for a period of time. Such a reform could ease the transition to a ‘new normal’ for workers affected by restrictions, particularly if they face returning to work at initially reduced hours: a situation which may last longer than previously hoped or anticipated.

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APPENDIX

The SWITCH model provides a detailed and accurate representation of almost all aspects of the Irish personal tax and benefit system. It does not include taxes on businesses (like corporation tax), which are difficult to assign to individual households, or expenditure on public services, which unlike cash transfers provided through the benefit system, are conceptually difficult to assign a value to (O'Dea and Preston, 2014).

The ITSim model estimates the indirect taxes (VAT and excise duties, including carbon taxes) paid by Irish households on the basis of their reported expenditure, collected by the CSO's nationally representative HBS in 2015-2016.

The main measures we include in our analysis of Budget 2022 using SWITCH are:

DIRECT TAXES

- Increase in income tax bands and credits;
- Increase (and cash freeze) to various USC and PRSI thresholds.

INDIRECT TAXES

- Carbon tax increase;
- Tobacco tax increase;
- Cash freeze to other duties.

SOCIAL WELFARE

- Personal rate of benefits increased with proportional increases for qualified adults and children;
- Working Families Payment increase;
- Living Alone Allowance increase;
- Fuel Allowance payment and threshold increase;
- Carer's Allowance disregard increase;
- Disability Allowance earnings limit increase.

OTHER

- Extension of National Childcare Scheme (NCS) Universal Subsidy to under 15s; cash freeze to NSC thresholds and rates of payment.