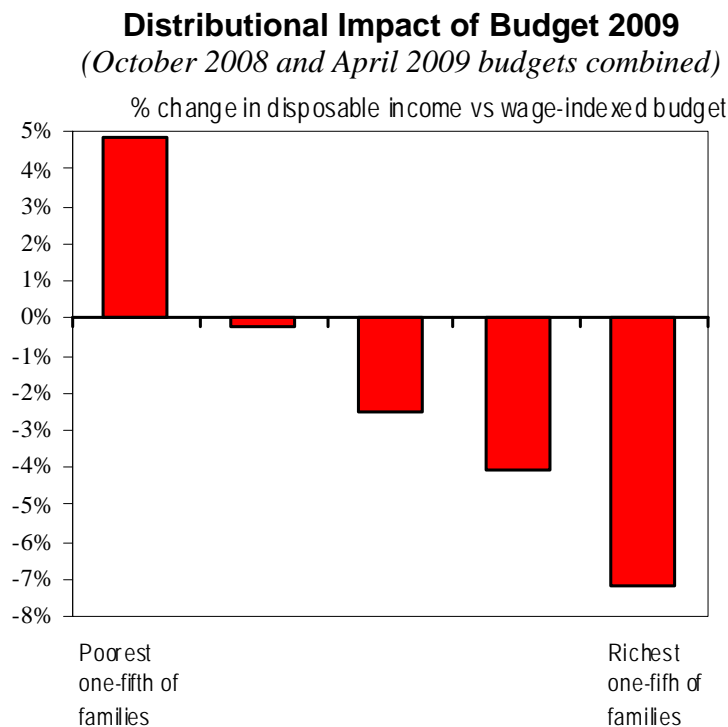


## *Budget 2009 Hits High Incomes Hardest*

The Supplementary Budget had to take steps towards restoring balance to the public finances. How has the burden of adjustment been shared? For a reliable answer to this question we must analyse how the tax, levy and welfare changes affect a large-scale representative sample of the population rather than a handful of hypothetical families. Here, we use the ESRI tax-benefit model to assess the impact of Budget 2009 on the incomes of families in the CSO's Survey on Income and Living Standards, uprated and adjusted to represent the 2009 situation.

Last Tuesday's supplementary budget represents the final instalment of budgetary policy for 2009. We concentrate on measuring the impact of the total package for 2009, incorporating the October 2008 Budget and subsequent amendments, the public service pension levy, and the Supplementary Budget's levies, PRSI increases, restrictions on mortgage interest relief and reductions in some welfare payments.

We have long argued that the baseline against which actual policy should be evaluated is one which ensures equal income growth for all elements of society, by indexing welfare payments and tax bands in line with growth in earnings. The same logic applies now, when wages are declining in the private sector, and public sector pay is subject to a new pension-related levy. Implementation of such a policy would mean that incomes would, in current circumstances, decline equally at all levels of income. The rate of decline is uncertain, but for current purposes we assume an average fall of 2% in wages between 2008 and 2009.



Average incomes for the poorest one-fifth of the population are set to rise by close to 5% above the benchmark. For the next one-fifth of the population incomes on average are broadly unchanged – though there are of course gains and losses within that group. Average losses for the middle and upper income groups range from 2½ per cent to over 7 per cent. For the top 10 per cent of income earners, the losses are greatest, at close to 9 per cent. Overall the Budget package is therefore strongly redistributive, with income gains for those with the lowest incomes and the percentage losses rising with income. (Similar remarks apply if the benchmark used is the traditional one of no change in nominal values of welfare and tax parameters). Shifts of this magnitude take place rarely, and usually over a sequence of budgets: the magnitude of these shifts in a single budget has few if any precedents.

On the highest incomes, the effective tax rate, including levies, has risen from 43½ per cent in 2008 to 52 per cent in 2009. Standard rate taxpayers faced a rate of 22 per cent (including the health contribution) in 2008 and will face rates of 26 or 28 per cent in 2009. These are similar to the marginal tax rates in force in the early to mid 1990s. Where should tax policy go from here? Some indications of future base-broadening rather than rate increases are given in the Budget, with much weight being placed on the forthcoming report of the Commission on Taxation. We comment on three of these.

Child benefit is to be either means-tested or taxed. There is a crucial difference here. Means-testing the benefit implies a withdrawal of some or all child benefit above a given income level. This effectively creates a new tax or “benefit withdrawal” rate in the system, on top of those which already exist. By contrast, making child benefit taxable creates no new tax rates, but allows for a gradual withdrawal of benefit through the tax system: those on lowest incomes get the greatest net benefit, those on top incomes the least, and standard rate taxpayers an intermediate amount. Property tax is also mentioned, and a key element here is the structure of any exemptions or partial waivers for property tax liability for those on low incomes. Again, these can in effect create new tax rates. It is important that the design of the tax system takes these factors into account in an integrated way rather than piecemeal. Likewise, the substantial levies introduced mid-year need to be reintegrated into the main tax system.

Turning to carbon tax, one element of proposals for the implementation of a tax has been to provide compensation for welfare recipients. In the light of the analysis set out above, with prices stable or falling, and net incomes falling elsewhere, the 3% increase in welfare rates for this year could be seen as “compensation in advance”. This would speak for an early implementation of a carbon tax.

The halving and eventual reduction of the Early Childcare Subsidy steps back from one recommendation of the Commission on the Family, while introduction of free pre-schooling implements another. Much will depend on the detail here, and a key theme of the Commission’s work was that quality pre-schooling could be provided in different ways. It is heartening therefore that the approach seems to be a broad one allowing for different types of service provider rather than imposing a single model.

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