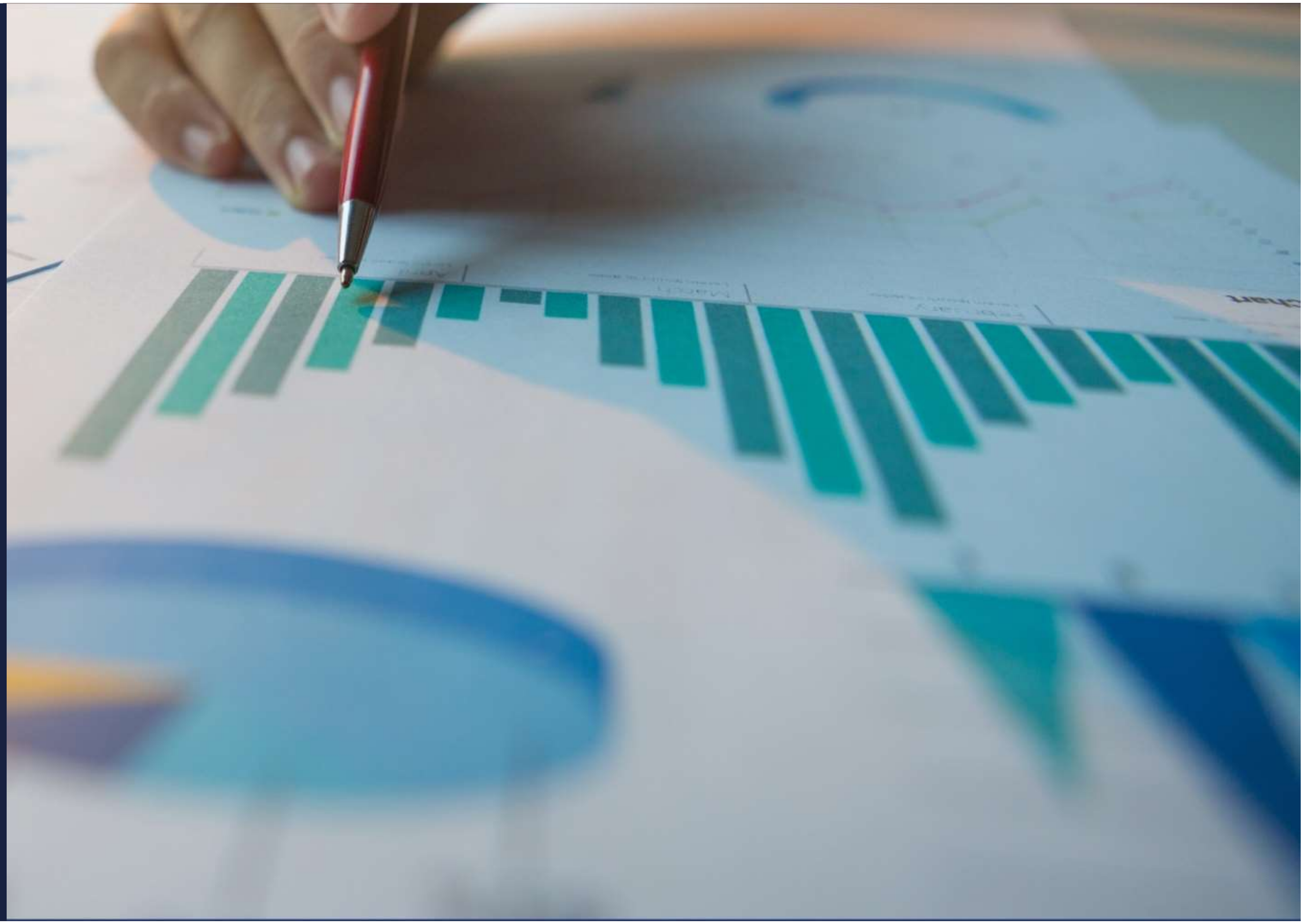
ESRI Post-Budget Briefing

Budget 2023: Distributional impact analysis



DATE
30th September 2022

Tax, Welfare & Pensions team
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Karina Doorley
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The distributional impact of Budgets 2021-23

1. Have tax and welfare changes kept track with inflation since 2020?

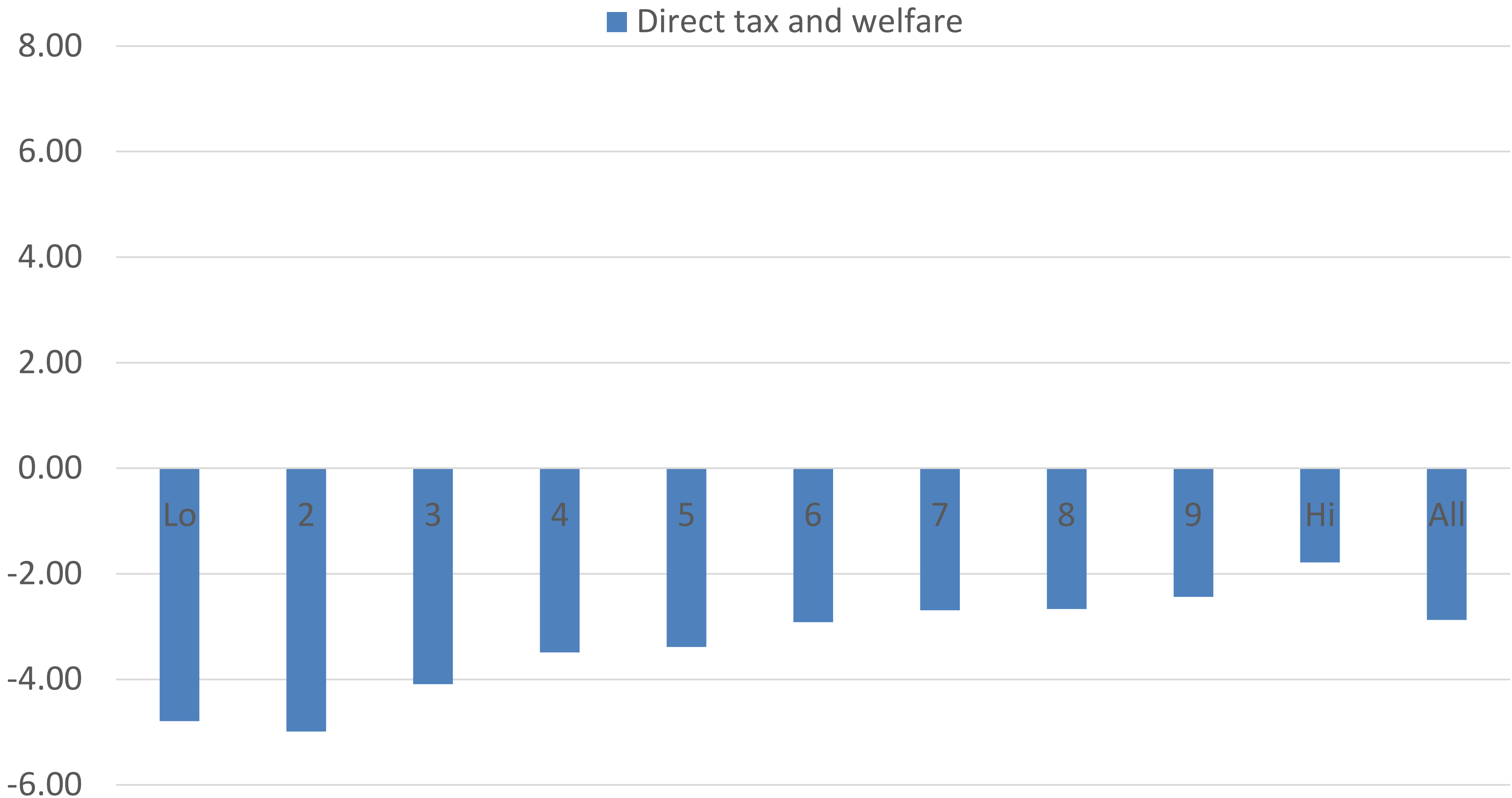
- For the current population, compare 2022 tax-benefit policy (including one-off measures) to inflation-proofed 2020 tax-benefit policy (11.1%)
- Accounts for wage growth of 8.3% between 2020 and 2022
- Indication of real gains/losses of purchasing power from Budgets 2021/22

2. What is the distributional effect of Budget 2023 compared to an inflation indexed Budget (7.1% DOF)?

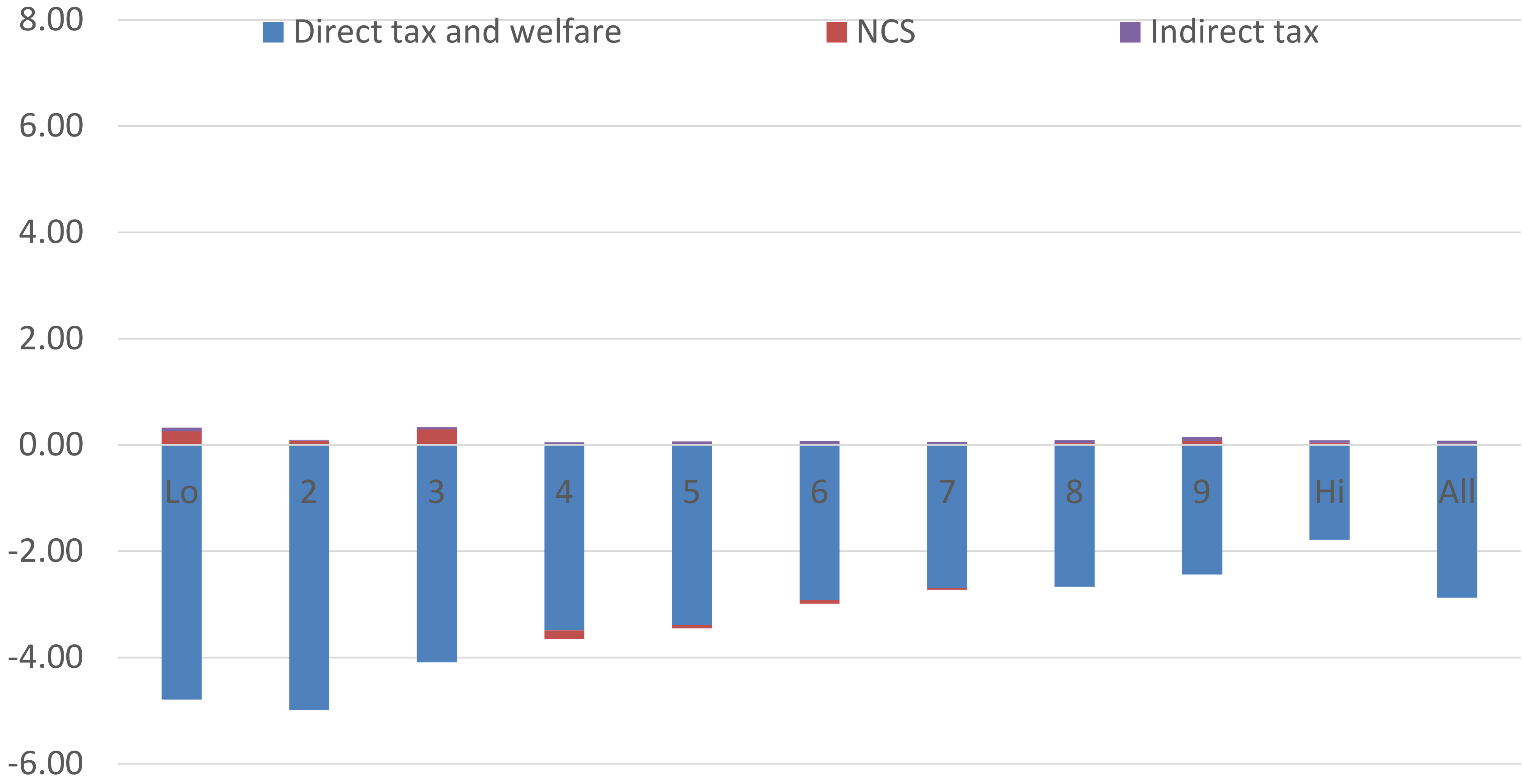
- One off policies excluded from baseline but included in reform
- Accounting for wage growth of 4.5% between 2022 and 2023

1. Have tax and welfare changes kept track with inflation since 2020?

Direct tax-benefit changes 21-22 did not keep pace with inflation of 11.1%



Indirect tax reform and childcare subsidy reform were in line with inflation



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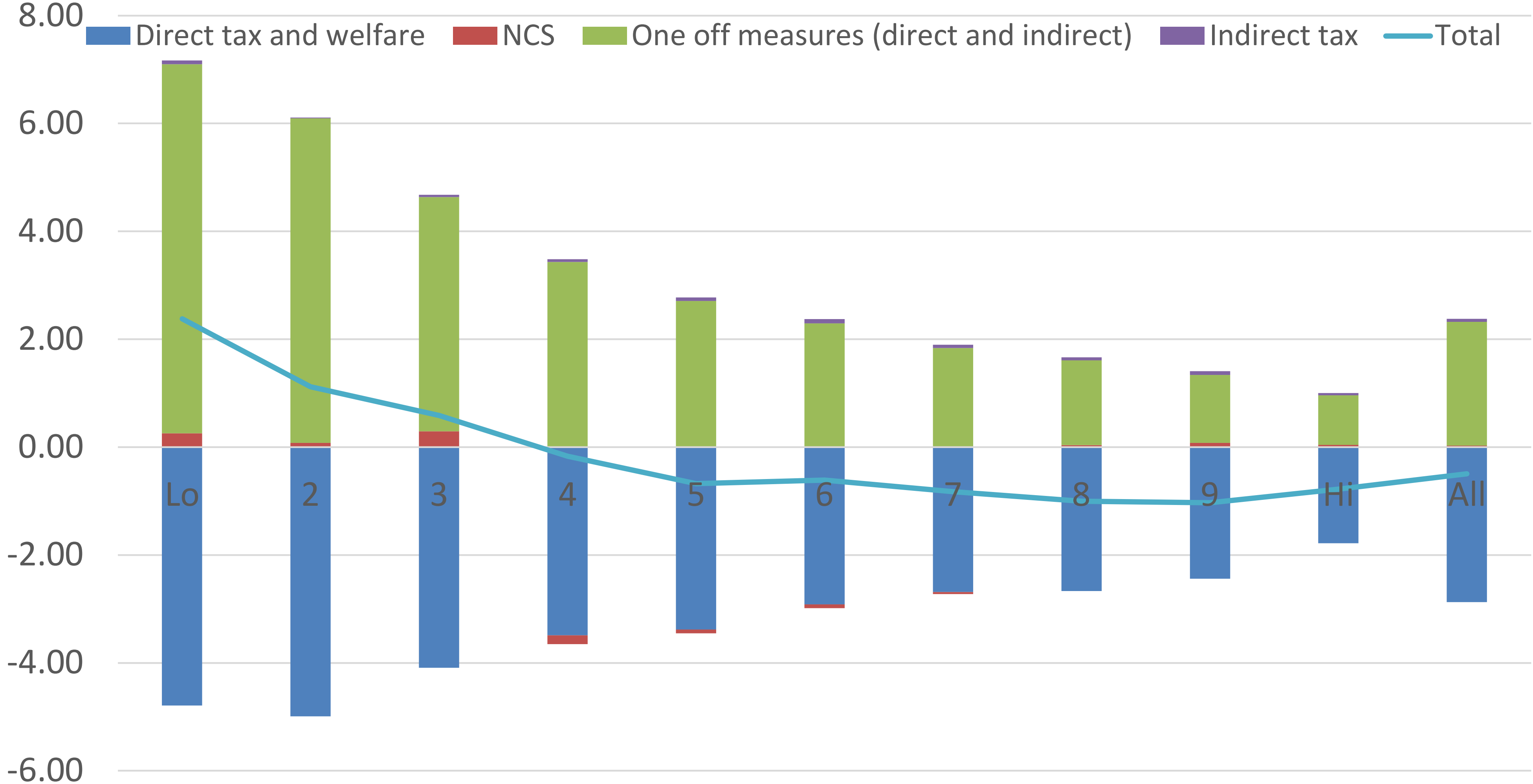
But one-off policies have provided substantial income support



2. What is the distributional effect of Budget 2023 compared to an inflation indexed Budget?

Budget 2023 – main measures analysed using SWITCH and ITSIM

Income tax

Bands/credits increased for workers; 2nd USC band extended, rent tax credit

Welfare

Personal rate of benefits increased €12 with proportional increases for qualified adults. QCI up €2; Working Families Payment increase; Fuel Allowance threshold and means assessment changed; earnings disregard for DA

One-off policies

Energy credit, extension of excise reduction and 9% VAT rate

Non-cash benefits

Universal Childcare Subsidy increase of 90c per hour; GP visit cards extended to those on or below median income. Free school books for primary level.

Indirect tax

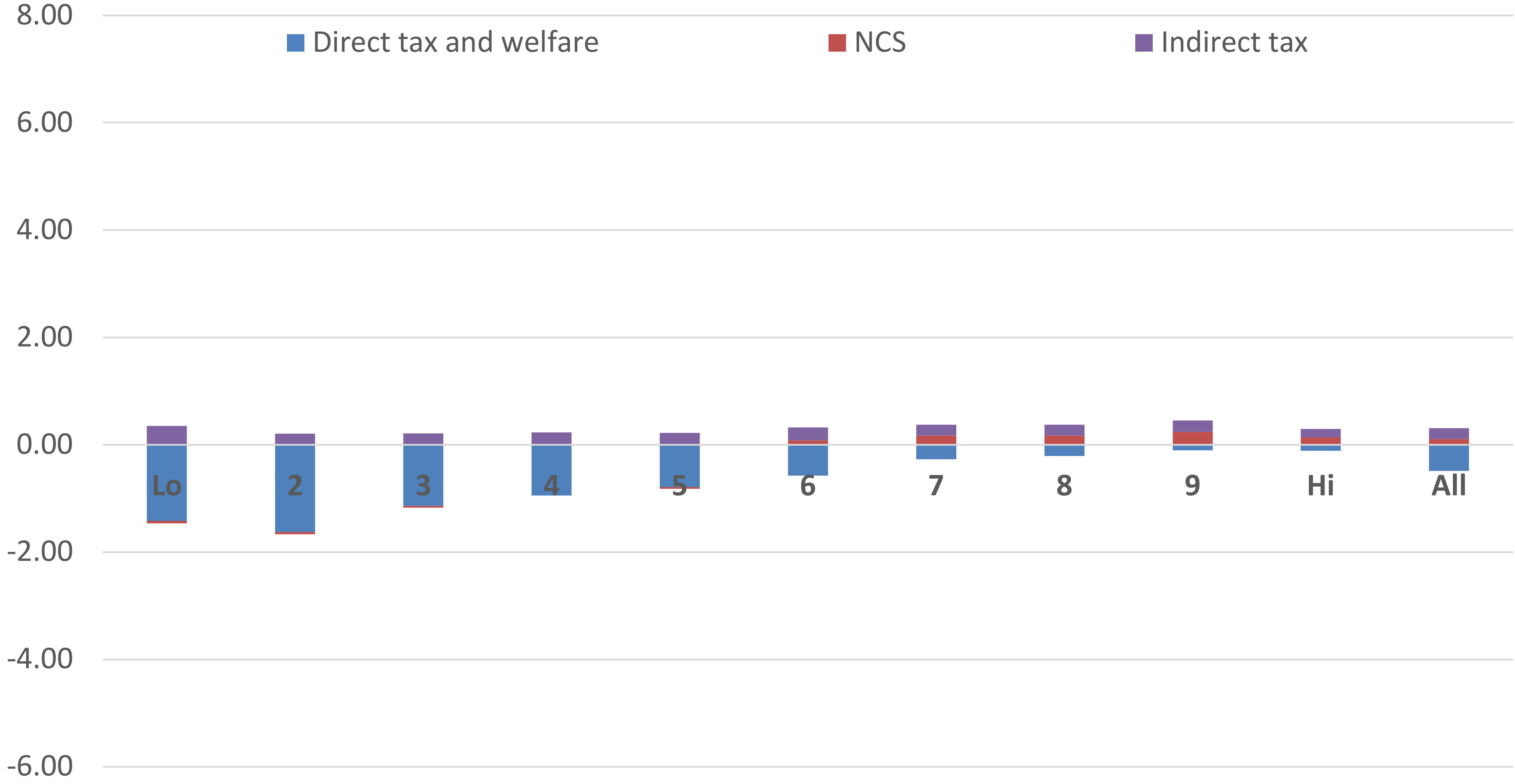
Tobacco excise + 50c; carbon tax + 7.50/tonne – offset by NORA levy; VAT cut on newspapers

Caveats

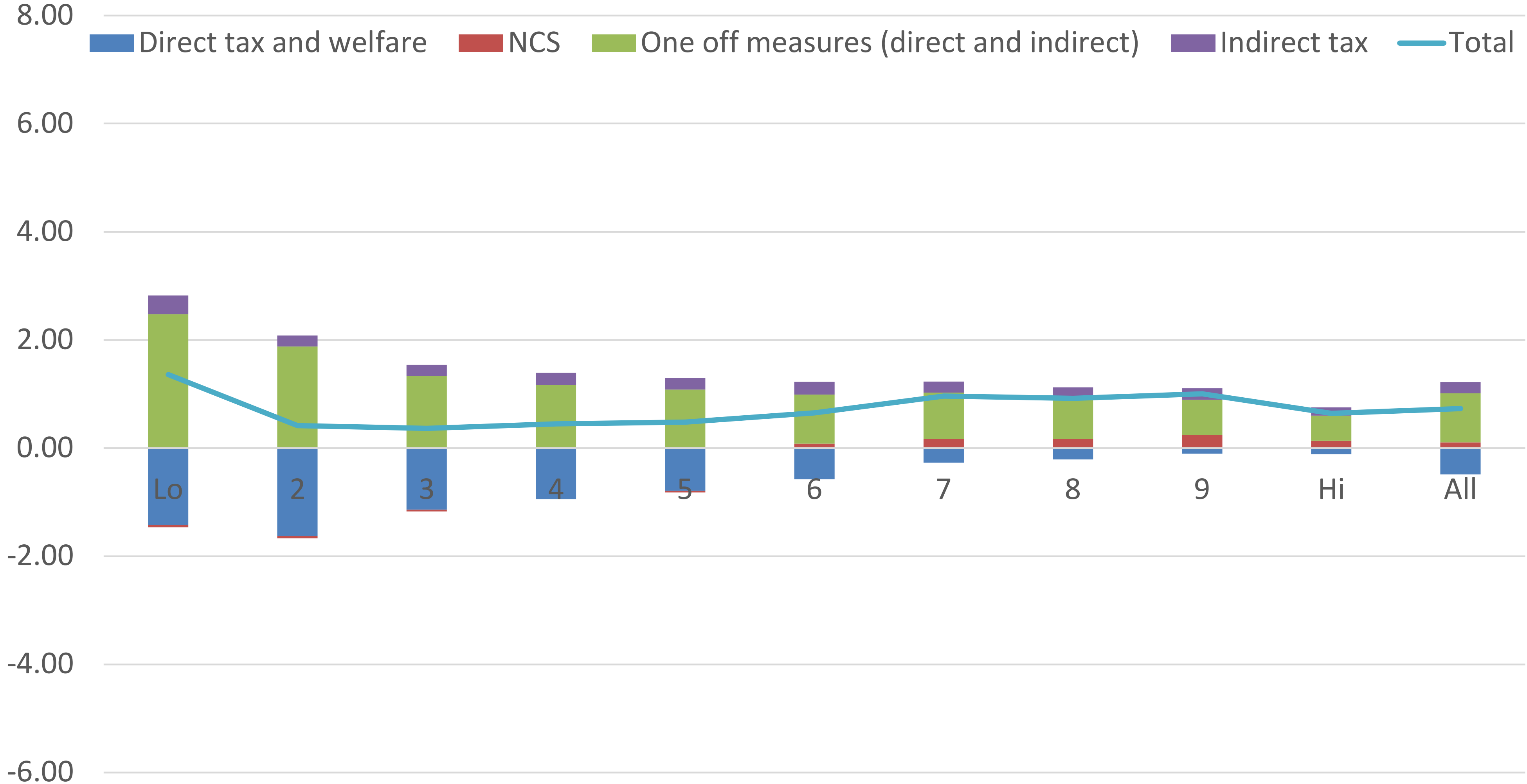
Don't model everything (childcare price freeze, SUSI grant changes, value of new GP visit cards)

Permanent tax & welfare changes next year won't keep up with inflation

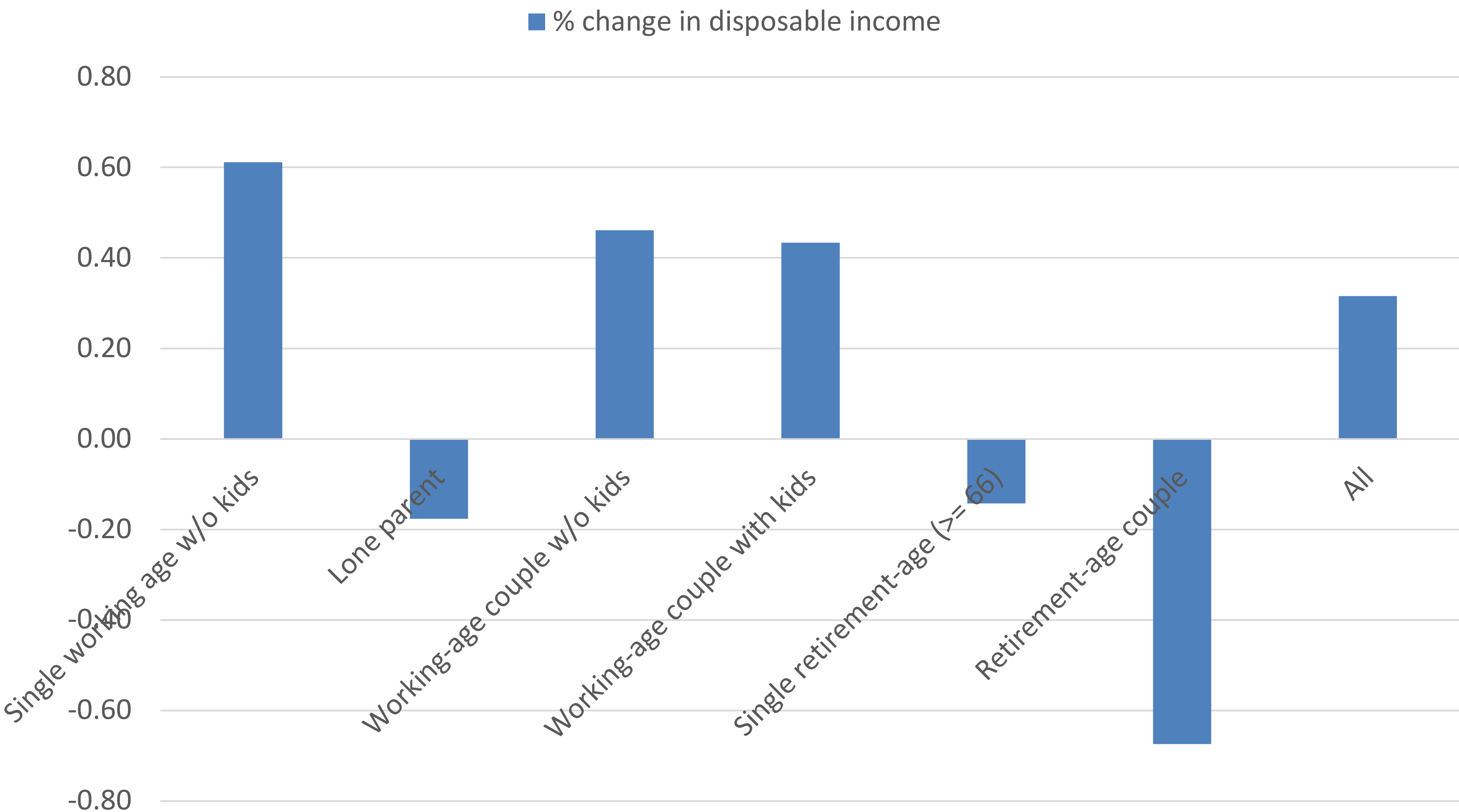
Indirect tax changes and childcare subsidy reform reduce average income losses



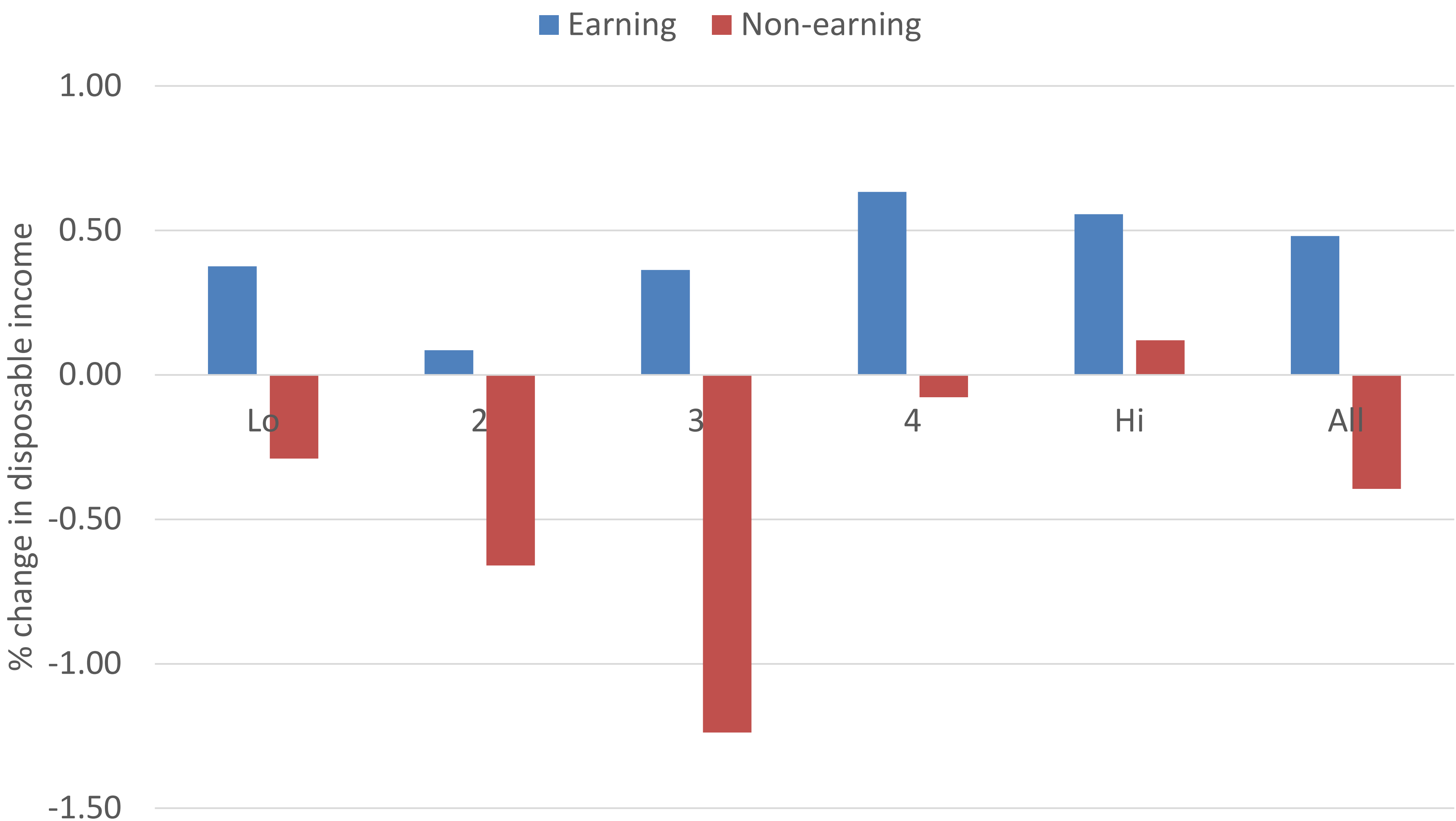
…as do one-off policies for 2023



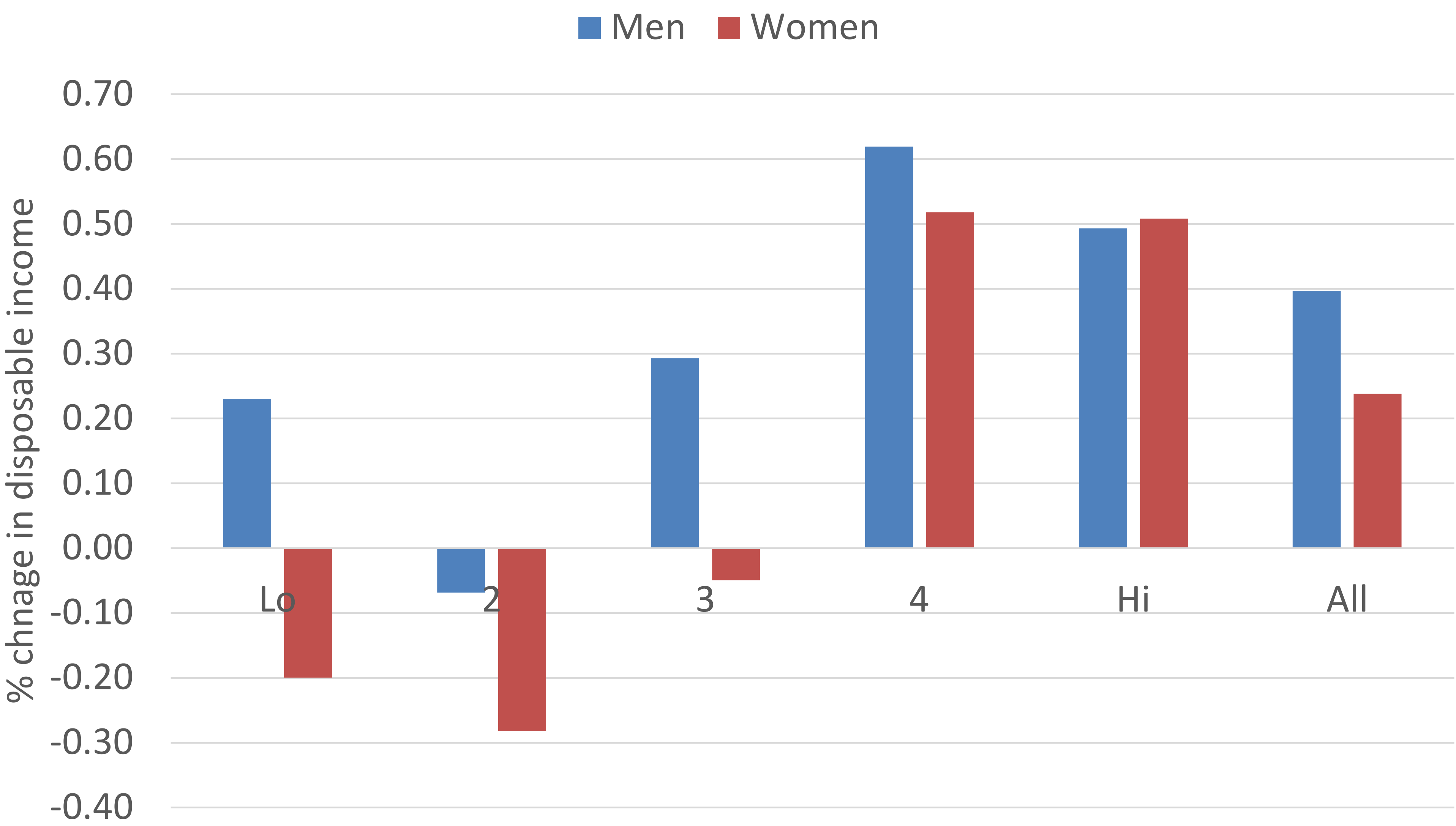
Lone parents and pensioners slightly worse off in 2023, compared to price adjusted 2022 policies



Non-earning households are also slightly worse off in 2023, compared to price-adjusted policies

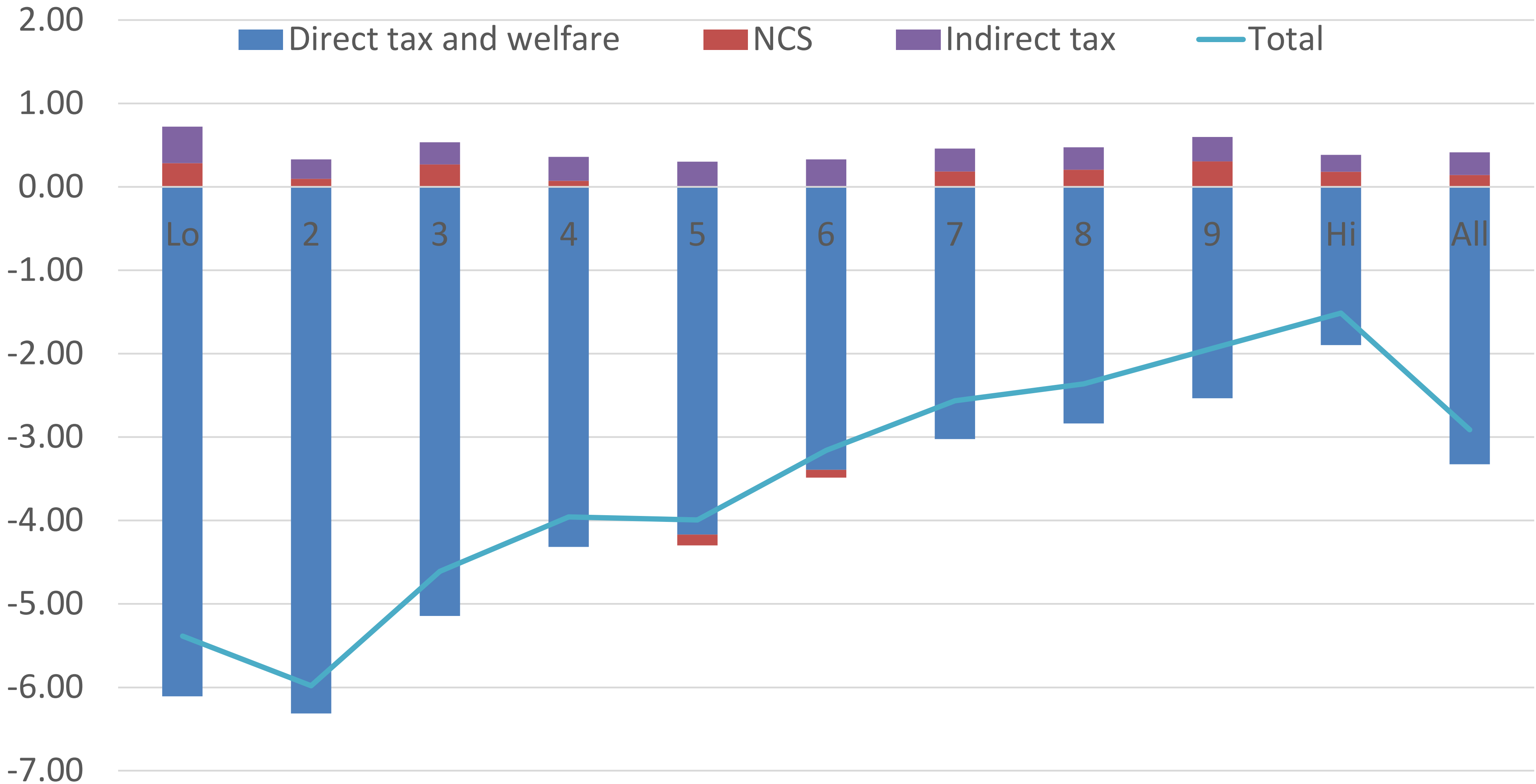


Policy changes for 2023 benefit men slightly more than women, compared to price adjusted policies



How might this picture change if one-off policies are not repeated?

Without the one-off measures, Budget 23 changes result in large regressive income losses compared to price-indexed 2020 policies



Conclusion

Conclusions

- One-off policies this year and next will substantially cushion incomes, particularly for low-income households
- Households will be slightly better off next year compared to a scenario of full price indexation
    - Exception of lone parents, pensioners and non-earning households
    - Implications for inflation?
- Permanent budgetary changes benefit high income households most.
- Long-term challenges remain for low-income households when one-off measures lapse
- Role for benchmarking of social welfare when inflation crisis passes

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Budget 2023 tax & welfare measures

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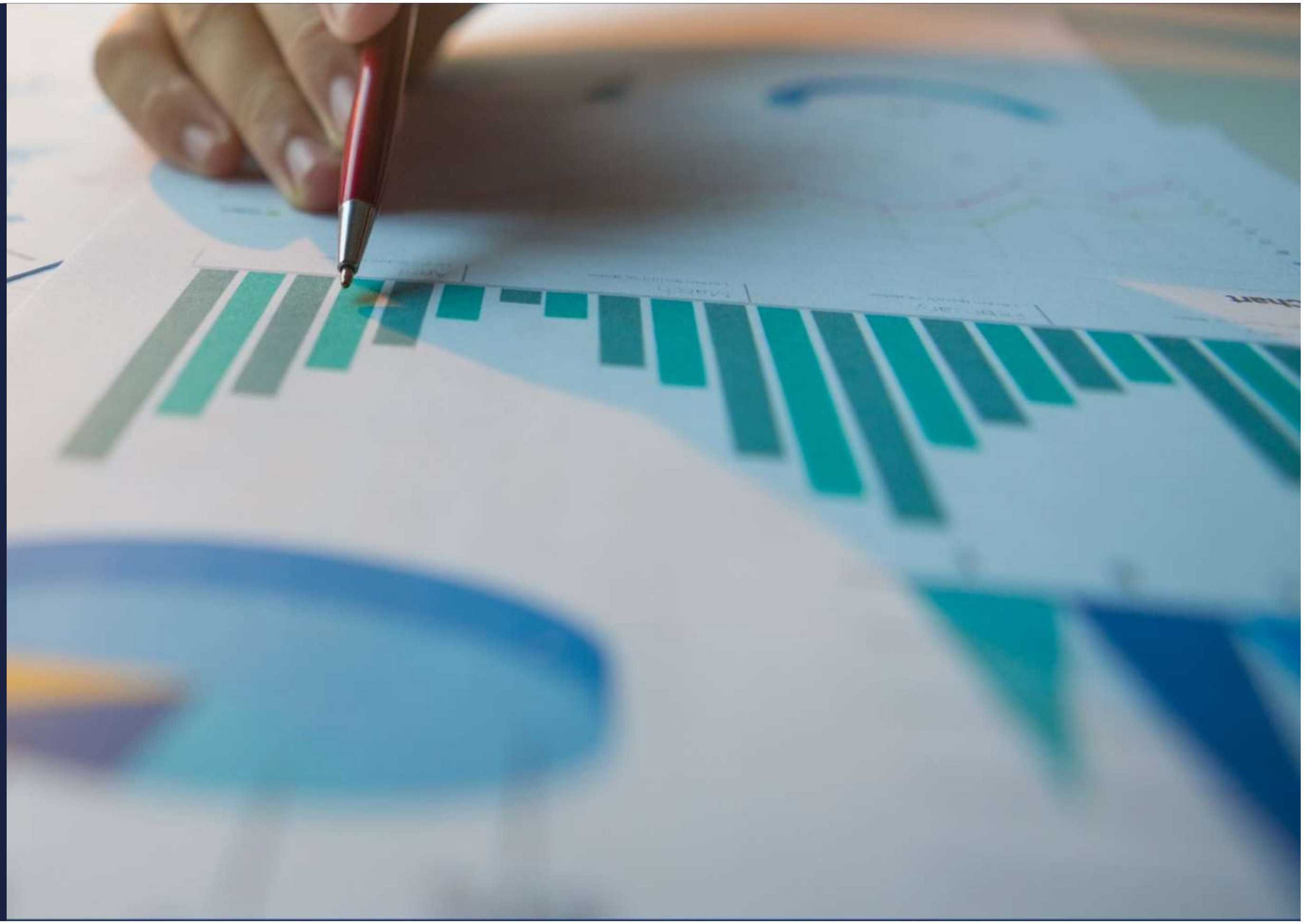
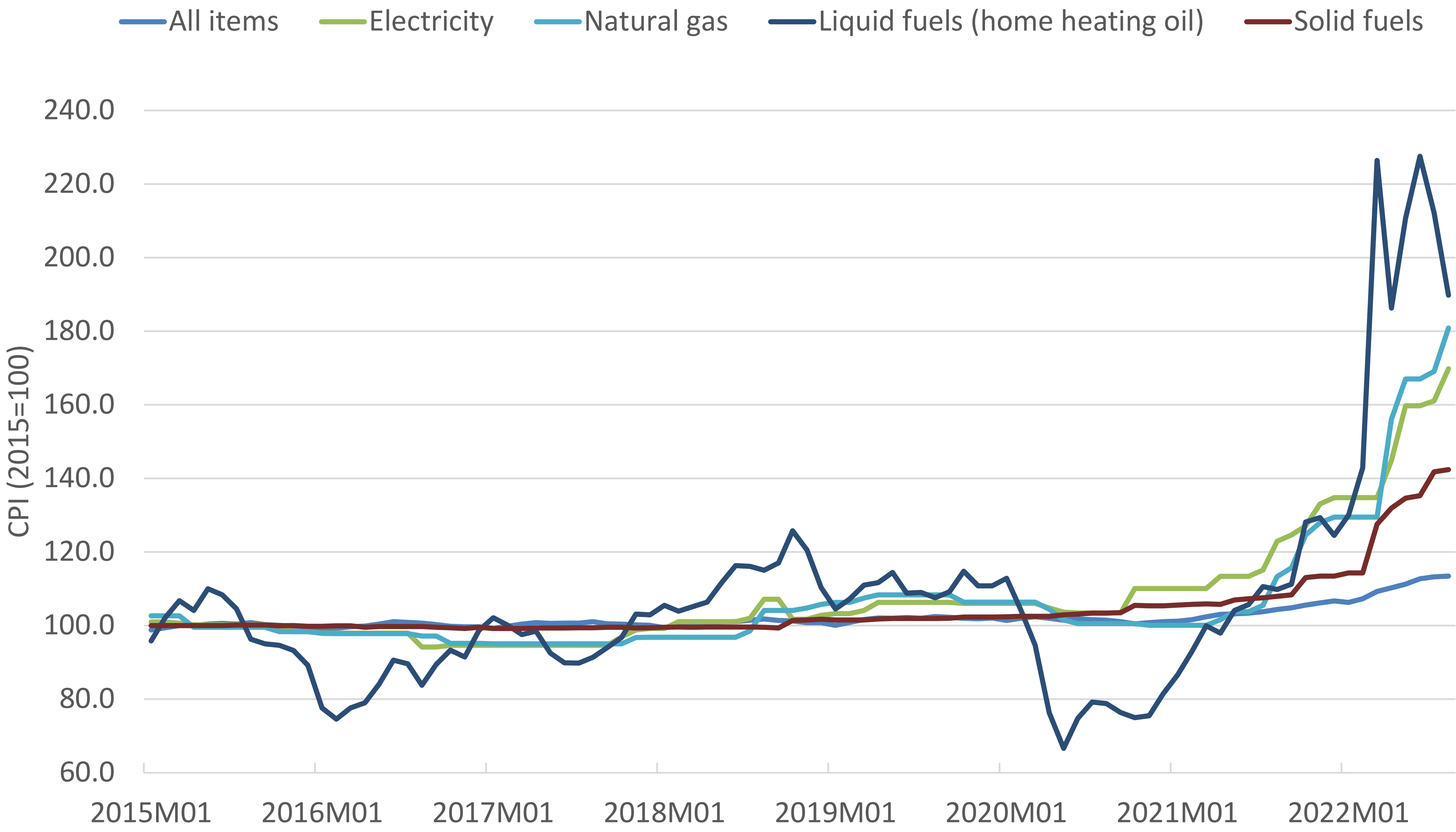
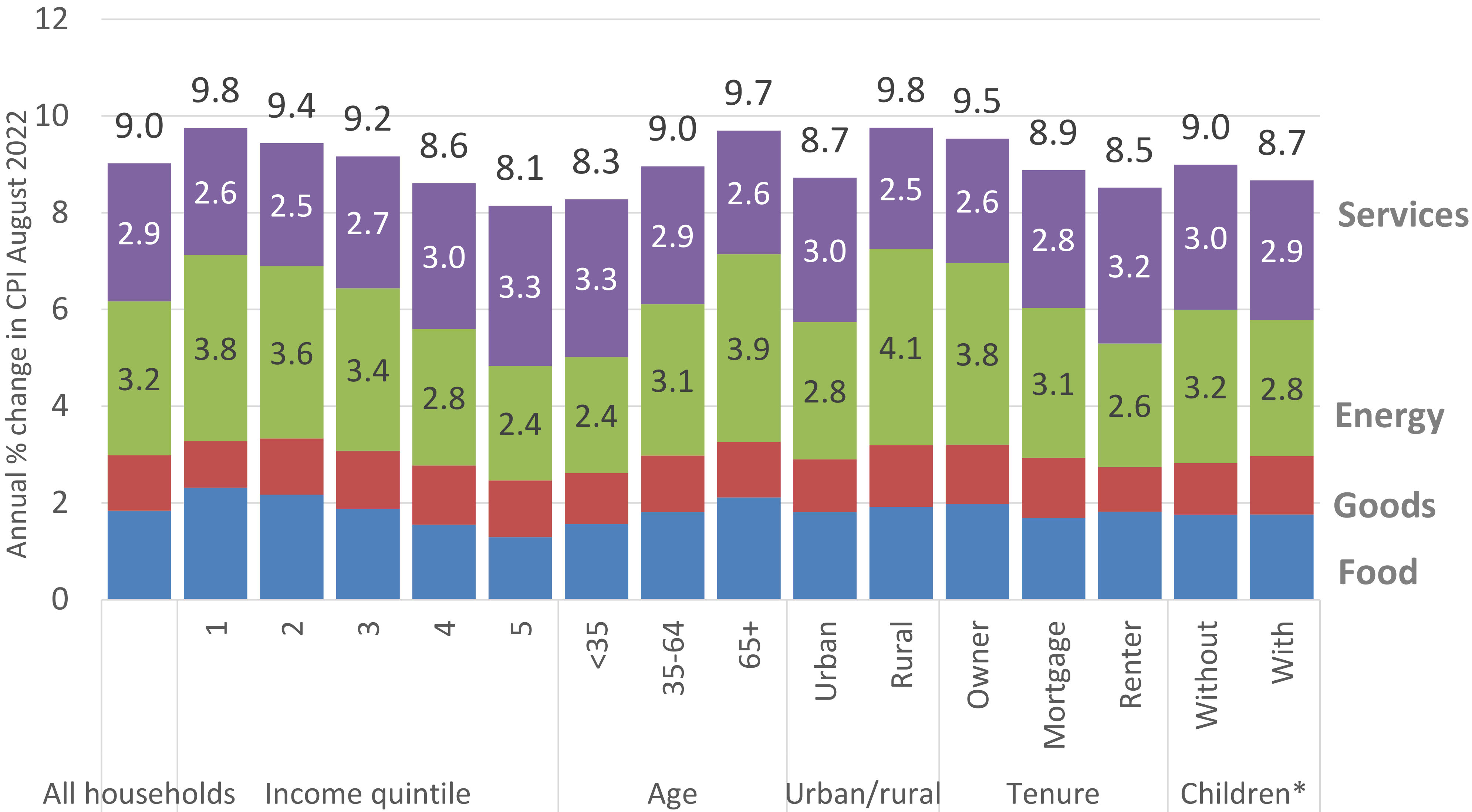


Context for Budget 2023 is the rising cost of living



… especially for low-income, rural & older households



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Substantial package of once-off measures this winter

Measures are timely, temporary & somewhat targeted

- "Halloween bonus" double payment of many welfare payments
- Lump-sum payments of €200-500 to recipients of certain welfare payments (including WFP, fuel & disability allowances)
- … and more universal measures: double child benefit payment in Nov & x3 €200 household energy credits (Nov, Jan & March)

Preserves incentive to reduce demand for those who can

- Contrasts with energy price cap which while providing greater certainty for households runs greater risk of rationing/blackouts
- … as well as large (and highly uncertain) cost for the exchequer

Big € ↑ but real ↓ in most welfare payments next year

Increases of €12 per week to max. rates of most payments

- Equates to rise of 5% for State Pension, but 6% for main & 10% for u25 rate of Jobseekers Benefit (expected inflation of 7%)
- €pw increase easy to communicate but changes the connection between rates of payment & adequacy in ad-hoc manner

Fuel Allowance eligibility widened for carers & pensioners

- … but not claimants of WFP or working-age welfare payments

Follows large real cuts to all welfare payments last year

- May lead to issues of adequacy next Autumn/Winter without repeat of “once-off” measures

Likewise, real cut to most tax credits & thresholds

Below inflation (c.4%) rise in main income tax credits with most PRSI & USC thresholds frozen in cash terms

- Effective tax rise as cuts purchasing power of after-tax earnings

Exception is Standard Rate Cut-Off (40% starting point)

- Will rise by €3,200 (9%) to €40,000 per year for single adults with proportional increases for married couples
- Mainly benefits higher income HHs as 2-earner couples gain twice

Welcome promise of a roadmap for personal tax reform

- Will need to address how to pay for keeping State Pension Age at 66 & longer-term issues around sustainability of public finances

… with some real ↓ & some real ↑ to indirect taxes

Cash freeze to excise duties except tobacco (+50c/pack)

- Amounts to large real cut in alcohol & (non-carbon) fuel duties

Rise in carbon tax more than offset on petrol & diesel

- On top of real cuts, extension of 'temporary' reductions till end of February 2022 and elimination of 2c/litre NORA levy
- Need for longer-term shift away from motor excise duties to congestion charges or time-location varying road pricing

Permanent VAT cut on newspapers & misc. health items

- Ireland an EU outlier in high share of expenditure subjected to reduced & zero rates of VAT

Other supports announced for families & firms

Expansion of Student Grant Scheme & cut to reg fee

- Details TBC but seemingly large real increases in grants

Increase in subsidies for formal childcare

- NCS Universal Childcare Subsidy increased by 90c/hour, but cash freeze (real cut) to income limits for means-tested subsidy

And new Temporary Business Energy Support Scheme

- 40% of rise in bills (capped at €10k/month) covered for eligible businesses who have seen >50% increase in average unit price

… alongside range of interventions in housing market

New €500 income tax credit for private sector renters

- Backdated to 2022, but won't benefit those in receipt of HAP/RS or those working <30 hours at the new minimum wage

Triple LPT rate applied on homes vacant for >12 months

- Positive addition to suite of supply side measures

Extension of Help to Buy for 2 more years at €350m cost

- Abolition recommended by Mazars review & CoTW

… and new 10% levy on certain concrete products

- Burden likely to fall on residents of newly built homes rather than industry: not clear why these should fund Mica redress

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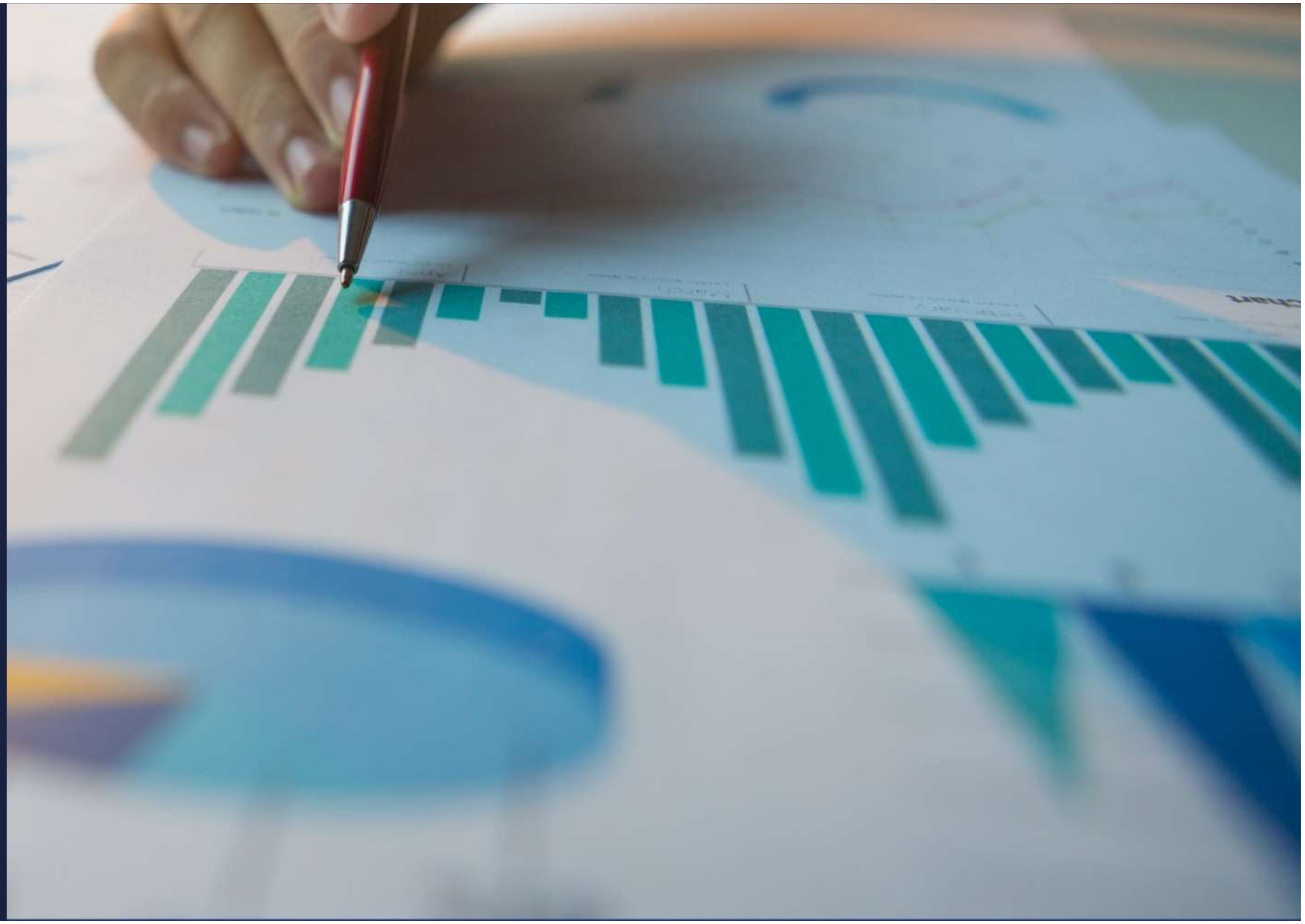
Budget 2023: A Macroeconomic Perspective

EVENT
ESRI Post-Budget Seminar

DATE
September 30th 2022

AUTHORs
Wendy Disch & Kieran McQuinn



Context

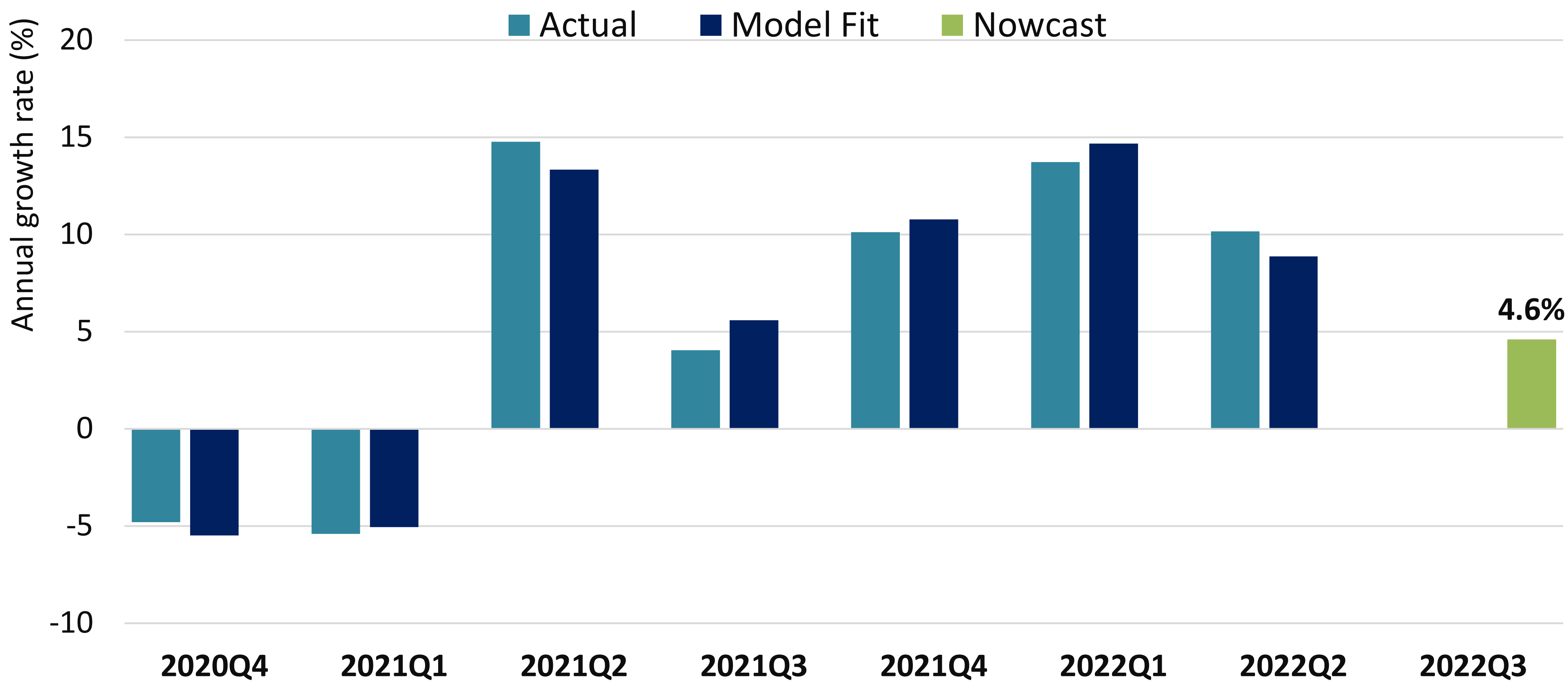
- Budget framed against robust growth in the Irish economy but significant global challenges.
- Need to support households and businesses vis-à-vis increased cost of living
- However avoid additional inflationary pressures
- Labour market:
  - Unemployment reaches historical lows
- Fiscal outlook:
  - Can we afford budgetary measures?
- Exposure to UK economic shock?

Robust economic performance

- Despite significant global challenges, Irish economy continues to exhibit strong growth.
- Factors contributing to the outlook include:
  - Elevated savings levels
  - Rapid recovery in the labour market
  - ICT and pharmaceuticals largely unaffected by global conditions?
  - Strong investment activity on non-construction activity
  - Continued increase in taxation receipts
- Challenges to the outlook
  - Increased risk of recessions in key OECD economies
  - Difficulties in energy markets
  - Inflationary pressures and
  - Increasing interest rates

Source: ESRI calculations and EU Commission

Nowcast of Modified Domestic Demand



- Modified domestic demand rebounded significantly in Q1 2022 and is expected to continue growing at a moderate pace.
- The significant growth in modified investment is driving much of the growth in MDD.

Public Finances: Strong performance in tax receipts…

- Overall taxation receipts increased substantially in 2022:
- For the period January-August, tax receipts have continued to grow strongly.
  - Income tax (+16% Y-on-Y)
  - VAT (+24% Y-on-Y)
  - Corporation tax (+**68%** Y-on-Y)
  - Excise Duties (-1% Y-on-Y)

- We anticipate total growth in tax receipts to be **27.4 per cent** overall in 2022, largely due to the rise in corporation tax.
- Tax revenue overall is expected to continue to grow for the rest of 2022 and 2023, and hence public debt ratios are expected to continue to decline.
- Government expenditure has been lower than the same period last year, although much of the surplus realised this year is now being used for one-off supports announced in Budget 2023.

Impact of budget?

- Ordinarily:
  - Not prudent to put so much money into a thriving economy
  - Particularly with unemployment so low
- However exceptional set of circumstances
  - Tax changes / business supports provide support for households and firms
  - Cushion the impact of energy costs on growth in 2023
  - Childcare costs particularly welcome given tight labour market
- Housing measures mixed
  - More supply needed overall
- Fiscal capacity is there for now!
- Less dependency on volatile corporate taxes:
  - **Rainy day fund** is welcome to meet medium-term challenges such as housing, climate change, and healthcare
  - €2 billion set aside in 2022; €4 billion in 2023

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UK Macroeconomic Uncertainty

- Market reaction to the "fiscal event" last Friday very adverse
  - Significant increase in borrowing
  - Impact of tax cuts on inflation (8.6 per cent)
  - Debt sustainability over the medium-term?
  - Capacity of UK economy to grow – Brexit?
- Sterling fell to lowest rate vis-à-vis the dollar since 1985 (€1.05)
- Markets now expecting emergency increases in UK interest rates
- UK rates now at 2.25 per cent
- Expectation they could hit 6 per cent by May 2023
- BoE intervention Wednesday the 28th of September
  - Significant difficulties in pension fund industry

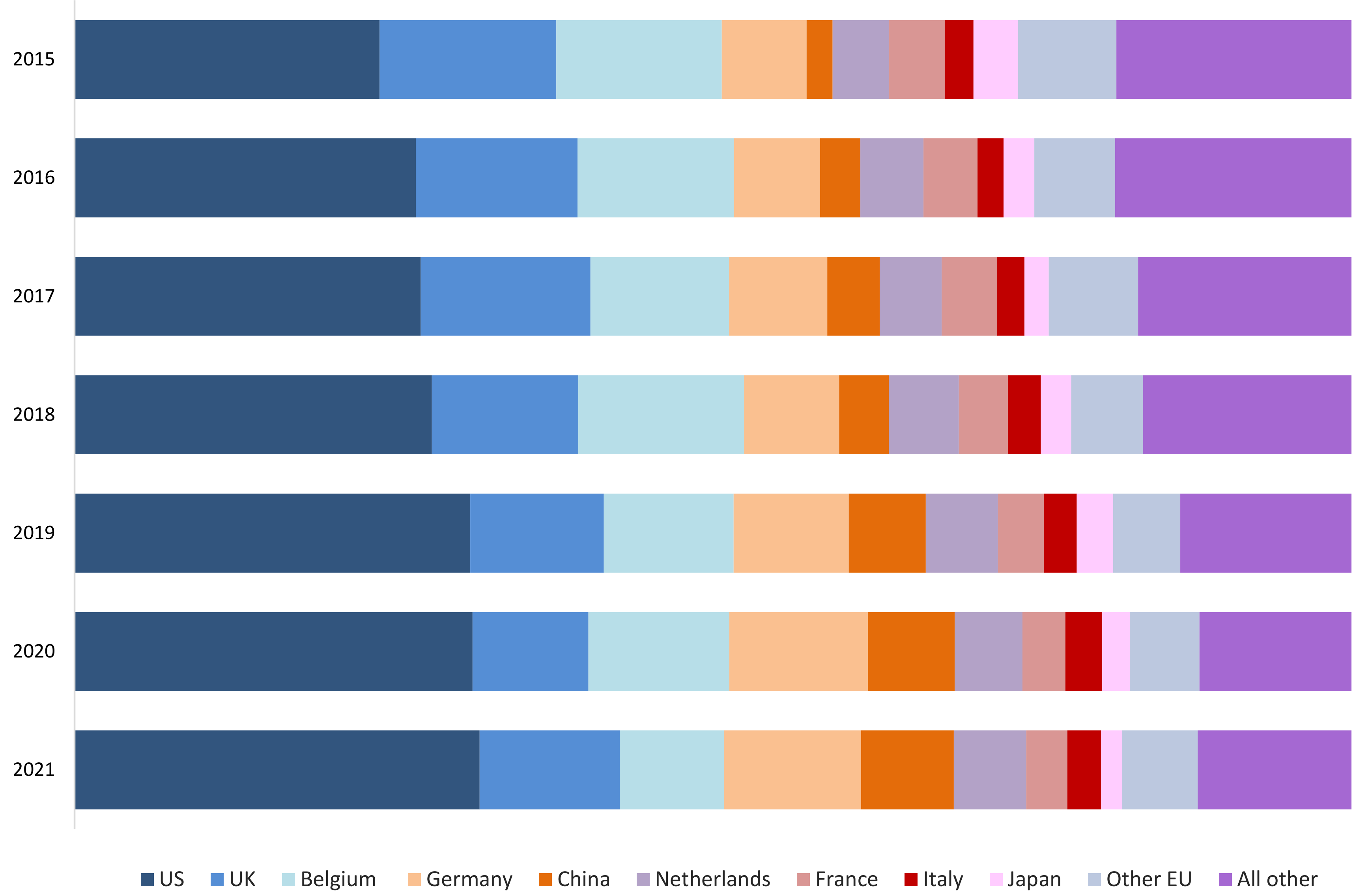
Sterling Dollar Exchange Rate: 1970 - 2022

Sterling Euro Exchange Rate: 1999 - 2022

Credit Default Swaps: June 2020 – Sept 2022

Share of Exports from Ireland by Trading partner

(merchandise trade, % share of total value)



Implications for domestic outlook?

- Irish financial sector less integrated with the UK since GFC
- Most deleveraged significant shares of their UK books
- Irish financial sector much healthier now than 2007/08

- However,
- Many Irish SMEs still trade with the UK
- Already been some financial market implications
    - For Irish institutions with UK exposures
- A comprehensive overview of contagion effects difficult

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Assessment

- Deteriorating geo-political situation has exacerbated pre-existing inflationary pressures and given rise to concerns about European energy security

- Despite this, domestic economy still expected to increase,
    - ICT and pharmaceutical sectors remain largely unaffected by global slowdowns.

- In addition to externally determined inflationary issues, the Irish economy is set to encounter domestic pressures
    - Particularly tight labour market at present

- Overall impact of Budget should help to (partially) stabilise household incomes and provide businesses with a certain buffer to deal with increasing energy costs

- Scale of package likely to fuel some inflationary pressures

- However more assistance may be required

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Thank You