

3.3

Individualisation: Fables and Facts

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Introduction

The introduction of what was termed “individualisation” of the standard rate tax band in Budget 2000 led to a heated debate about the merits or otherwise of the proposal. Much of this debate centred on issues of fairness or equity – both vertical equity (as between persons at different points on the income scale) and horizontal equity (equal treatment of equals, or no unwarranted discrimination). Some of the disagreements had to do with deeply held value judgements. But other disagreements arose from the lack of a common understanding of the facts of the situation. In these circumstances a number of myths or fables held sway. The time is now ripe for a cooler look at the issues, to disentangle facts from fables, and see what can be learned from this experience and put to use in shaping a future tax policy that will contribute to fairness and economic prosperity.

Individualisation and Family Policy

During the debate about individualisation there was a tendency to view the pre-reform tax treatment of married couples – which involved full transferability of bands and allowances - as a system that was “pro-family”.¹ By contrast, the new individualisation arrangements were characterised as being “anti-family” in their effect. On this view,

¹ The system could also be described as one involving “income-splitting”, or doubled personal allowances and rate bands for married couples.

individualisation is associated with individualism,² whereas a family-centred policy must involve full transferability of allowances and bands between husbands and wives.

Let us tease out some of the elements underlying this approach. The introduction of the income-splitting or full-transferability system represented a response to a Supreme Court judgement in the Murphy case. This declared the previous (joint taxation) system to be discriminatory against two-earner couples, and unconstitutional. The reason given in the 1980 Budget Speech for the decision to move to full transferability was that

“A narrow approach towards effecting the Supreme Court’s decision would lead to unjustifiable discrimination against the one-income family, particularly where a married woman elects to care for the family on a full-time basis at home rather than take up work outside the home”.

This can be viewed as putting the emphasis on the provision of a tax subsidy for childcare undertaken by married women in the home. But, as Callan and Farrell (1991) point out, the subsidy “is not conditional on having children, but simply on marital status”. This means that the benefit from this tax subsidy is, in terms of its main stated objective, rather inefficiently targeted. Fahey’s (1998) analysis of Labour Force Survey data found that “many who receive the subvention are not engaged in childcare and many of those with young children who have a heavy childcare burden do not receive the subvention”. He suggested that alternative uses of the resources – including the possibility of a greatly increased Child Benefit – could “serve the purposes of family policy a great deal more effectively and efficiently than does the present approach, as far as income tax and married couples are concerned”.

² This view is expressed by, among others, the former Taoiseach John Bruton, who referred to “pure individualism, and its associated political programme of individualisation” in a speech of 16 August 2004 (Fine Gael website).

These considerations suggest that individualisation does not necessarily involve an orientation towards individualism. Individualisation can form part of a package of measures reorienting and strengthening support for families. The retention of full transferability could be an inefficient and ill-targeted use of resources. Much depends, therefore, on the make-up of the overall package of which individualisation forms a part – something considered in the final section of the paper.

Individualisation and Married Women’s Labour Market Participation

Improving the financial incentive for married women to take up employment was one of the explicit aims of the individualisation measure. One of the most heated elements of the debate concerned whether or not this would represent a good outcome for Irish society. “Individualisation is a naked attempt to increase female participation in the labour force and to coerce women, who might otherwise opt to work at home while their children are young, into the labour force.” (Deputy J. Mitchell, Dáil Debates, 27 February 2001). There was little discussion of exactly how much of an increase in female participation might be expected, but the impression gained from some of those opposed to individualisation was that a great many women would be “forced into the labour market” as they put it.

It is interesting in this context to look at how the labour force participation rate for married women has evolved over time, both before and after the introduction of individualisation. Figure 1 shows the participation rate for married women from 1971 to 1999, and from 2000 to 2003. There is a strong upward trend in participation, but no evidence of an acceleration associated with the introduction of individualisation. Of course, it could be that participation would have “flattened out” in the absence of individualisation, or that the full response to the tax changes is not yet apparent.

The study by Callan, van Soest and Walsh (2003) examined this issue in considerable depth, estimating and simulating behavioural responses to the tax changes. Their results suggest that a package involving full individualisation of tax bands, and a revenue-neutral reduction in tax rates, would lead to a rise in married women’s participation of between 2 and 3 percentage points. While this represented a stronger response than that to standard forms of tax cut (rate cuts, increased allowances or band widening) it should be remembered that the actual package introduced included provisions for a Home Carer’s Allowance, and only partial individualisation of the bands. For these reasons it is clear that the impact of individualisation on married women’s participation rates can be expected to be quite modest, compared with the strong upward trend over the past thirty years.

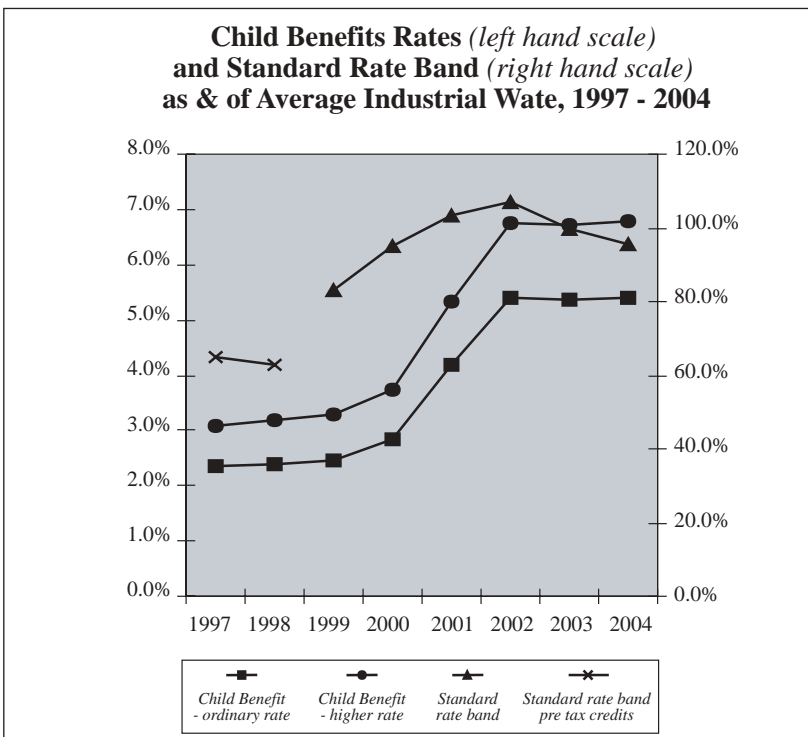
Figure 1



Individualisation and the Distribution of Income

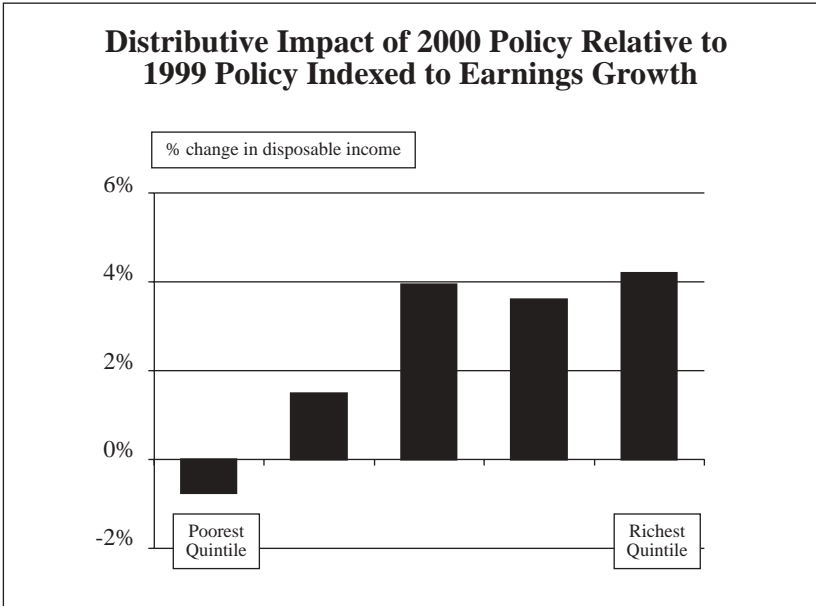
The first stage of individualisation involved not just a structural change in the treatment of couples, but a substantial widening of the standard rate band for single people and two-earner couples. In subsequent years, there was some further widening of the band, but also very substantial increases in child benefit. Figure 2 illustrates the evolution of child benefit rates and the standard rate band in relation to the average industrial wage.

Figure 2



Evaluation of the impact of “individualisation” depends critically on what benchmark is used to assess the impact. I have argued elsewhere that a “distributionally neutral” benchmark, provided by a wage indexed budget, is of considerable value.

Figure 3:

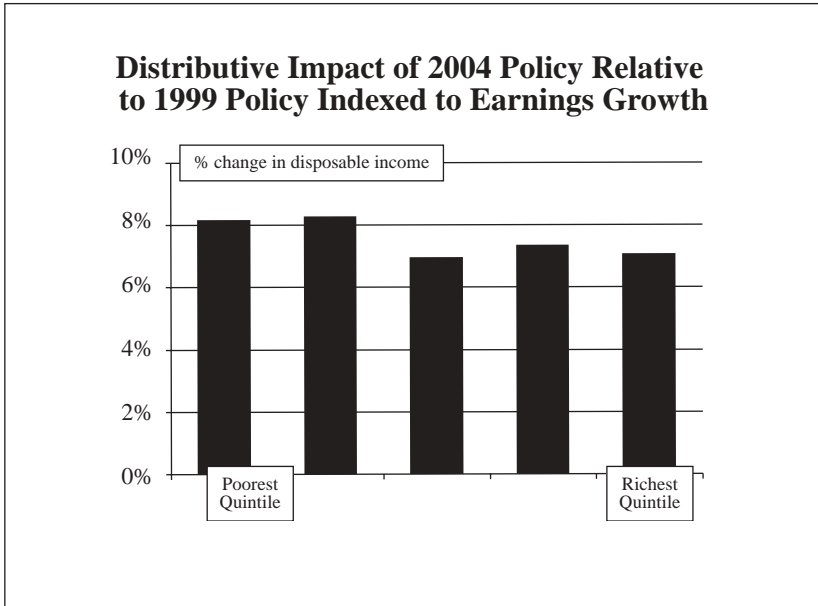


Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or “quintiles”

Here I provide two pictures of the impact of individualisation. The first (Figure 3) is simply the impact of Budget 2000, in which individualisation was introduced. It shows that the benefits of Budget 2000’s tax and welfare package were skewed towards middle and upper income groups.

The second (Figure 4) is the impact of Budget 2004 assessed against the pre-individualisation policy (Budget 1999) indexed in line with wage growth. This allows an assessment of individualisation in the context of the overall policy package which has evolved over the past three or four years. The net effect is very even across the income distribution, with a slight “pro-poor” bias.

Figure 4:



Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or “quintiles”

Conclusion

There are many lessons to be learned from the individualisation process and the associated debate. There is a clear need for accurate and timely information on the likely impacts of policy changes in order to allow informed debate and guide policy choices. Tax and welfare policy packages will often combine regressive and progressive elements. It is important to keep the overall effects of tax and welfare policy on income distribution, the labour market and the macroeconomy in mind.

References

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