What Has Happened to Marginal Tax Rates?

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As the economy boomed in the early 2000s, income tax rates were reduced, tax credits were increased and the standard rate band was widened. With the onset of the crisis in 2007-2008, and the collapse of revenues from capital gains tax and stamp duty, major increases in taxes on income were introduced to sustain and increase tax revenue.What has been the net impact of these policy changes on marginal effective rates of tax on income? This is one of the topics examined in a recent conference paper.[†]

When deciding about whether to accept or look for additional hours of work, or to seek promotion or a job at higher levels of skill and pay, it is the net financial gain which is of primary interest. High marginal effective rates of tax reduce the incentive to progress in the labour market. The marginal effective rate of tax refers not just to income tax, but takes account of PRSI, income levies and the Universal Social Charge – along with any reduction in social welfare payments to the individual concerned or to his or her partner. We focus in this paper on the marginal tax rate applying to an increase in earnings of €100 – equivalent to about a day and half's pay at the minimum wage.

In order to identify the impact of the sharp changes in policy, we examine the distribution of marginal effective tax rates for those in employment under three scenarios. For each of the scenarios we keep the relevant population and income levels constant – at their projected values for 2011 – and allow policy to vary. We contrast the actual 2011 policy with both the pre-crisis policy (as of 2008) and the policy in force in 2000, when the fiscal balance could be regarded as more sustainable than in the immediate pre-crisis years. The policy parameters for 2000 and 2008 are adjusted in line with wage growth or decay between the relevant year and 2011 – this ensures that the overall proportion of income taken in tax is kept close to that in the base year for the policy.

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The results in the table below show that for 7 out of 10 workers, the marginal effective tax rate increased by more than 5 percentage points between 2008 and 2011. Such an increase would have been expected because of the introduction of the income levy, later replaced by the Universal Social Charge, and reductions in the standard rate band. However, it is perhaps more striking that comparison with the 2000 policy scenario indicates that for 4 out of 10 workers, there is an increase of more than 5 percentage points in the marginal effective tax rate. These results indicate that recent tax increases have done much gone further than simply reversing recent tax cuts, and that most workers now face significantly higher marginal effective tax rates than 10 years ago. While there are difficulties in finding precisely comparable analyses for other EU countries, analysis of the situation in Ireland compared to other countries is now a priority.

Marginal Effective Tax Rates: Impact of Policy Changes, 2000-2011 and 2008-2011

Marginal Effective Tax Rate	2000 Indexed to 2011 Policy	2008 Indexed to 2011 Policy
Percentage point change in METR	**(%)**	**(%)**
Fall of 10 percentage points or more	13.0	1.6
Fall of 5 to 10 percentage points	4.8	8.7
Fall of 2 to 5 percentage points	1.0	0.9
Fall or rise of under 2 percentage points	14.9	3.6
Rise of 2 to 5 percentage points	26.1	9.8
Rise of 5 to 10 percentage points	23.4	61.8
Rise of over 10 percentage points	16.8	13.5
Total	100.0	100.0

[†] T. Callan, N. Crilly, C. Keane, J.R. Walsh, A. Ní Shúilleabháin 2011. "Public policy towards the sale of state assets in troubled times: Lessons from the Irish experience", *Utilities Policy*, Vol. 19, pp. 193-201.