

REDISTRIBUTIVE FORCES OF THE IRISH TAX-BENEFIT SYSTEM*

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Abstract: This paper charts the main changes in structure of the Irish system of tax and social benefits over the period 1955-2002. It analyses the evolution of the redistributive forces in the system over the period and considers the effect of the incremental reform on the complexity of policy and resulting impact on incentives.

Keywords: welfare state, tax-benefit system, social assistance, replacement rate, poverty trap

JEL Classifications: H24, I38.

1. INTRODUCTION

This paper examines the forces within the Irish personal tax-benefit system which drive redistribution within it. The Irish tax-benefit system is in many respects typical of the Anglo style of welfare state, with relatively insignificant social insurance systems, where means testing and progressive income taxes are more important (Esping-Andersen, 1996).

There are a number of important differences between the UK and Irish tax-benefit systems. Firstly, means testing tends to be more important in the Irish case (see Evans *et al.*, 2000). Social insurance is less well developed than in the UK, with benefits payable at a flat rate and with no earnings related components.¹ Although flat rate benefits tend to be of higher value than in the UK (see Callan, 1997), the absence of an earnings-related old-age pension results in lower social insurance

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contributions. Having a larger self-employed population, the coverage of social insurance also tends to be lower.

Structurally, Irish means tested benefits are designed differently to the UK. Instead of almost universal coverage for a common means tested benefit, Income Support, Ireland has a set of categorical instruments covering contingencies such as unemployment, old age disability, lone parenthood etc., with different means tests and eligibility conditions, but similar levels of benefit. Together, however, the system covers the same set of contingencies as in the UK. This reflects the incremental expansion of coverage of social benefits since the foundation of the state, at which point both countries had almost identical tax-benefit systems; in Ireland, there were largely no sweeping reforms such as the UK's Beveridge and Fowler reforms.

Like the UK, Ireland has a form of in-work benefit payable to families with children in work. Housing Benefits are less important, but growing in importance with the high house price growth currently in the country. Income taxes until 2000 differed from the UK in that couples had the option of having their income taxed jointly.² Furthermore, workers on average wages tend to have higher marginal tax rates, although again more recently these have fallen towards UK levels. Like the UK, however, the tax base tends to be wider than in other countries with fewer reliefs as, for example, social contributions are not deductible from the income tax base.

This paper describes the development of the Irish tax-benefit system in the modern era (from 1955-2002). Ireland has seen some of the biggest changes in Europe both socially and economically over this period. These changes have been accompanied by large changes in the tax-benefit system. This paper primarily focuses on the changes in the redistributive power of the Irish tax-benefit system as it currently stands and provides some of the historical context in which the system developed. Section three describes the principal trends in revenue and social expenditures over the period. Section four describes the structure of the Irish tax-benefit system and the main changes that occurred over the period. Section five describes changes in the implicit equivalence scales or, in effect, the official view on the economies of scale of living in multi-person households, in the system over time. Section six catalogues trends in the replacement rate over time. The replacement rate measures the ratio of incomes when out of work to in work. It is therefore a measure of the generosity of benefits compared to prevailing standards of living. Section seven considers the importance of the insurance element of the system. Section eight combines all the components of the system together and examines how different instruments interact. Section nine concludes.

2. HISTORICAL PERSPECTIVE

As Ireland until 1921 was part of the UK and subject to British laws, the early history of the welfare state was the same as Britain's. Social Services in the modern

sense did not develop in any country until the 1880s. Prior to then, only the Poor Law and basic education existed as an attempt to prevent extreme destitution at minimum cost (see Fraser, 1984; Powell, 1992; Cousins, 2002a, 2002b; Department of Social Welfare, 1953)

The basis of poor relief was in the medieval acts, such as the Poor Law Act of 1388, which were designed to prevent vagrancy. They arose because of a fear of social disorder caused by the movement of labourers in search of work from the destitution in their home parish. The Acts main instruments of dissuasion were the stocks and beatings.

However, by the sixteenth century, the attitude to vagrancy softened. Firstly, in 1536, parishes were authorised to collect money to support the poor. Later, after realising the potential for mass social unrest which changes due to depopulation could cause, the authorities instituted the Poor Relief Act of 1576 and the Poor Law of 1601. Support was provided for three categories of poor and destitute: the sick, the able-bodied poor and the idle. The act provided for the sick to be accommodated in poor houses, the able bodied to be set to work in workhouses and the persistent idlers to be punished in “houses of correction”; funds were raised by “poor rates” levied by parishes.

The poor law arose out of the needs of a largely agrarian society. However, industrialisation, population growth and migration in Britain in the late 1700s placed great strains on this system. At the end of the eighteenth century, food scarcity and problems associated with the war with France led to the introduction of payments or outdoor relief; such support was also available to those in work who were earning too little to support themselves and their families. However, the system was widely criticised for its increasing costs, its effect on wages and its incentives effects on work and population expansion and was therefore reformed in 1834.

The Poor Law Amendment Act provided for poor relief to be administered by residential workhouses, which were to be extremely harsh in an attempt to dissuade the poor from seeking relief. Thus, eligibility was reduced. However, this system, too, was designed for the agrarian poor who became destitute and not for the new industrial poor who might suffer temporary unemployment due to market forces. Indoor relief could not provide support for the large numbers who now experienced temporary poverty, so outdoor relief largely continued. In fact, at most only 15 per cent of paupers were ever in receipt of indoor relief.

Other social reform in the nineteenth century centred around education, public health and factory reform. Publicly funded and eventually compulsory primary education was introduced; public sanitation services were also introduced due to the spread of water borne diseases and laws were tightened on women and child employment.

The next period of reform occurred at the beginning of twentieth century with the liberal reforms when unemployment old age and health insurance were introduced, discussed in more detail later on. These reforms were largely as a result of changing attitudes to welfare provision and institutional influences. The prevailing view at the time was that economic growth depended on having a healthy and educated workforce. In addition, poverty studies by Rowntree (1902) amongst others found evidence that poverty was much more widespread than otherwise thought. Economic security also came to be seen as an integral part of individual freedom. Institutions such as friendly societies and the public service as well as working class pressure groups, also exerted an influence at this time. In an effort to prevent social unrest, Bismarck in Germany introduced social insurance as an alternative to the poor law and means tests and was later followed by Lloyd George in the UK.

Ireland inherited the structure of means tested benefits resulting from the poor laws and a number of social security schemes introduced before the First World War. The social security schemes included the Old Age Pensions Act 1908 which provided a means tested, exchequer funded pension for over 70s and the Unemployment Insurance Act, 1920 which covered manual workers in nearly all industries except for Agriculture and all non-manual earning below a certain amount. Benefit was initially paid to unemployed workers and in 1921 a reduced amount to dependants as well. None of these benefits were adequate to live on and it was expected that recipients would have to supplement their benefits from family, savings, other benefits or charity.

This system survived largely intact until after the war, although additional benefits were added to cover most contingencies. In 1947 the department for Social Welfare was established and in 1952 all the various schemes of insurance (such as unemployment, health and widows insurance etc.) were amalgamated into a single social insurance scheme. A maternity benefit came into operation in 1953 and an insurance scheme covering old age pensions for over 70s came into being in 1961. The new amalgamated scheme was different than the inherited schemes in that it provided for equal benefits for men and women, identical benefits for all contingencies, increases in respect of dependants and a disability benefit without a time limit to replace previous sickness and disability benefits.

For those without sufficient contributions a residual benefit, social assistance was developed in tandem with the contributory benefit system of social insurance. Payments tended to have been less and in Ireland the proportion of recipients of income maintenance who received the means tested payment has normally been higher than other European countries due initially to the large proportion of farmers and self employed who were not eligible for social insurance, a situation which has changed now and in more recent times because of the high proportion of long term recipients who have exhausted their insurance entitlements.

The first of the assistance benefits to be introduced was the means tested old age pension, introduced in 1909. Means tested unemployment, sickness and widow

payments were introduced somewhat later in the 1930s as a result of the widespread poverty induced by the depression and the economic war with Britain.

The third type of benefit in Ireland is universal payments which are made regardless of means or contributory record. These include the children's allowance introduced in 1944 (subsequently changed to child benefit) paid in respect of each child in a family, free travel for pensioners in 1967 and free fuel for long term recipients in 1980.

3. REVENUE AND EXPENDITURE 1955-2001

Table 1 describes trends in expenditure on welfare benefits and revenue from income taxes and social insurance contributions in Ireland between 1955 and 2001. Over the period, benefits rose from a relatively low base of 4.8 per cent of GNP in 1955 to a peak in the late 1980s before falling back in the 1990s until the present day. In the context of the classification, here into social insurance, assistance and universal child benefits, insurance benefits are the most important.³ Being the dominant expenditure, the trend in insurance benefit expenditures mirrors the trend in total expenditure. This however disguises the fact that assistance benefits too increased in value over the 1970s and 1980s, while there has only been a limited decline in total expenditure in the 1990s. Child Benefits on the other hand have been very stable at about 1 per cent of GNP from 1955 to the present.

Reasons for these trends are now examined. One of the main reasons is the change in the structure of the tax-benefit system. The period from 1950s until the 1980s, saw the expansion of the role of social insurance, from a less important position than social assistance in 1955 to being nearly twice as important in 1980. The introduction of widow's (now survivor's) and old age pensions in the 1950s and 1960s were the main factors. Unemployment insurance benefits existed from the foundation of the state, but too rose over this period, partly because it rose in real terms. A more important reason however is due to the expansion in "demand", especially in the 1970s for unemployment benefits and in 1980s for invalidity benefits. Both these factors can be explained by the severe economic position of Ireland during the late 1970s and during the 1980s. Rising numbers of unemployment initially increased unemployment insurance payments. As these benefits only last for 15 months at most, the continuing recession resulted in greater numbers having to rely on assistance payments. Youth unemployment also increased and thus the numbers without sufficient contributions increased. Furthermore, the poor economic position had the effect of discouraging individuals from seeking employment, resulting in the increase in invalidity benefits over this period.

The decline in the relative importance of insurance benefits in the 1990s has resulted from a number of factors. Firstly, demand has fallen because of higher employment levels. In addition, the cohort in retirement in the 1990s is quite small due to migration in the 1950s, hence the fall in survivor's and elderly insurance benefit

expenditure. There has also been lower indexation and a number of structural changes. For example, pay related unemployment and disability benefits were abolished. On the assistance side, the peak for expenditure occurred later, as the longest out of work, who are more likely to be receiving assistance benefits, were the last to experience the impact of the improved economic position of the country. Poor economic conditions in the UK also resulted in a large number of unemployed people returning from the UK to higher benefits in Ireland, but without sufficient contributions to be entitled to unemployment insurance. Government policy also aimed to reduce the difference in the rate of payment between different benefits and thus the less generous (mainly assistance) benefits were increased at a faster rate. Finally increasing family breakdown and extramarital births has resulted in an increase in the demand for lone parent benefits.

On the revenue side, total taxes increased over time from about 15 per cent of GNP in 1955 to 37 per cent in 1987, falling back in the 1990s to about 34 per cent. During this period, Ireland moved from a system typical of developing countries, where indirect taxes are more important than direct income-related taxes and contributions, to a European style system, where the direct taxes are more prominent. Prior to the 1980s, indirect taxes were more important than personal income taxes and social contributions, moving from two thirds of total taxes levied mainly on the household sector in 1955, to below half of in the post 1980 period. Taxes levied in general on the household sector rose from around 70 per cent in the pre 1970 period to about 80 per cent in the 1970s, rising to a peak due to the expansion in income taxation in the late 1980s before falling back in the 1990s as corporation tax returns have increased. The 1955-1987 period, therefore has seen a large expansion in the tax-benefit system and thus an increase in the potential for redistribution. Social benefits typically are more redistributive either due to targeting through the use of means testing or through the categorical nature of the benefits that tend to focus expenditure on groups likely to be poor such as the elderly, unemployed or disabled. On the taxation front, the move to progressive direct taxation from regressive indirect taxation will also tend to increase redistribution, thus levying relatively more taxation on the top of the income distribution.

4. CHANGES IN THE SYSTEM: STRUCTURAL CHANGES 1955-2002⁴

This section describes the structure of the Irish Tax-Benefit system and explains some of the main changes between 1955 and the present. Prior to the 1951 Social Welfare Act, the benefit system was different, relying on provisions that had existed since before the foundation of the state, back to the Poor Law and the reforms at the start of the Twentieth century. The structure of the income tax system in the pre-1955 period did not change significantly from independence, only rising in value to support increased expenditure during the Second World War.

4.1 Income Taxation

We now discuss some of the changes to the income tax system faced by employees. Since 1955, the Irish income tax system has moved from a highly patriarchal pre-1980 system to the optional joint income tax system of the 1980s and 1990s, to the planned move to individualised taxation after 2000. Prior to 1980, a wife's income was included with her husbands for tax purposes. Also the income tax system was characterised by a significant number of allowances in respect of dependants. The tax system therefore explicitly made a distinction between the principal breadwinner in the family and their dependants. In 1980, a High Court judgement which abolished the compulsory taxing of women's income with their husbands, allowing couples to decide whether they are taxed individually or jointly (See Kennedy, 1989). Because of the relatively low female, labour force participation rate in Ireland, many couples continued to have their incomes taxed jointly. Recently, there has been a concern that this joint system has led to work disincentive effects for secondary earners in a couple (typically the wife),⁵ a plan was announced in 2000 to move an individual system that makes no distinction as to whether a couple is married.⁶

In this section, we shall discuss in more detail these changes. To aid the discussion, we categorise income taxation into the following components: (a) the tax base and associated allowances/deductions/credits and (b) the tax schedule and marginal relief.

4.2 Tax Base, Allowances, Deductions and Credits

Firstly, the taxbase is determined. Allowances and deductions are deducted from taxable income, which consists of gross incomes and most cash benefits. Unlike continental systems, there are fewer employment-related deductions. For example, social insurance contributions and, travel to work or other professional expenses are not deductible. In addition, a number of incomes are exempt from income taxation such as a number of social benefits such as child related benefits.

Allowances, deductions and credits are grouped together here because they have similar objectives. In the 1999 Budget a series of reforms were introduced transforming many allowances into tax credits. The principal distinction is that allowances typically have fixed amounts that are deducted from taxable income, effectively operating as a tax band of zero per cent. Deductions are also deducted from taxable income. However they usually depend on expenditure on a particular item such as rent, mortgage interest, health insurance etc. to have a value. While allowances and deductions are deductible from the tax base, credits are deductible from income taxes.⁷ The distinction has the effect that in a progressive income tax system, allowances and deductions *ceteris paribus* result in higher tax reductions for those with higher incomes than tax credits. This is because allowances and deductions are subtracted from taxable income and thus take a higher value for higher marginal rate of taxpayers, while because tax credits are deductible from

income taxes, their values are the same for all taxpayers.⁸ While it is possible to design a reform of a system whereby the transition from allowances to credits can be done in a neutral way, the existence of tax credits, mean that future increases in their value are less targeted at the top of the income distribution. Thus in the long run they are a more redistributive instrument to those with low incomes and who pay tax.

Throughout the period of study until the introduction of credits, a single person allowance has existed. This however has decreased from over 60 per cent of the average wage in 1955 to about 40 per cent in 1973 to 20-30 per cent in the 1980s and 1990s, rising again, so that total tax credits are equivalent to an allowance of nearly 40 per cent of the average wage payable at the standard rate of tax in 2002.⁹ Therefore, for much of the period, the allowance has not kept pace with earnings inflation, increasing the proportion of workers who pay income tax and because of the progressive nature of the income tax system, increasing the redistributive nature of the income tax system. In table 2 we see the huge increase in employees registered with the revenue commissioners for income tax purposes since the 1960s. Over the entire period, allowances have also existed for married couples, widows and the elderly. A number of deductions exist for particular types of expenditure such as rent, mortgage interest, private medical insurance and private pension contributions.

The system has also reduced the number of instruments with horizontal redistributive objectives. In 1955, there were allowances for children, working wives, dependent relatives and for unmarried tax payer's who had a female relative caring for their relatives. The system was therefore similar to present day income tax systems in Southern Europe that include allowances for dependants of the taxpayer. The system therefore followed a "main breadwinner" type model, reflecting the low female labour force participation rate in Ireland at the time and supported the role of the family as a social shock absorber. It also reflects "softness" of state institutions, where outside the income tax system, the administrative capacity to deliver targeted family support did not exist.¹⁰ Gradually, these horizontally redistributive instruments were reduced in value through inflation and eventually abolished, so that by 1986 almost all of these instruments were eliminated, with horizontal redistribution to families accomplished through the benefit system.¹¹

Until the late 1990s, allowances and deductions were generally permitted at the marginal rate of tax. In other words the higher the marginal rate of tax paid, the more valuable the allowance. However, in the 1999 budget it was announced that the main tax allowances would become tax credits. This act would tend to increase the degree of progressivity of the income tax system.

4.3 Tax Schedule and Marginal Relief

Once the tax base has been determined, income tax is levied through the income tax schedule or the system of rates and bands.¹² In addition, for those on low incomes

there is a parallel individual/joint system with a separate system of allowances and rates known as marginal relief.

Much of the progression in the tax system results from a multi-banded increasing tax schedule. This has existed in a permanent form since the Finance Acts of 1972 and 1974. Prior to this, a surtax was in operation that included graduated bands for high-income earners. For most taxpayers, income tax was paid at a flat standard rate with reduced rates for those on lower incomes being introduced occasionally. Until 1973, the degree of progressivity in the tax system was expanded as the marginal rate of tax for each band was increased. Since the top marginal rates have tended to fall. The marginal rates for those with lower incomes also fell until 1980, and increased then over the 1980s until the tax reforms of the late 1980s. Over the course of the 1980s, the size and complexity of system of tax bands and rates was reduced significantly. In 1976 there were 6 bands varying from 26 to 77 per cent. The 1990s has seen a relatively stable tax schedule, with tax reduction being focused on increasing the width of the lowest tax bands, effectively reducing the marginal rates for those affected. However due to the existence of progressive taxation, increases in bands benefit those with the highest marginal rates most.

Until High Court Judgement of 1980, married women's incomes were taxed with their husband's. Subsequently, as in the case of a number of other European countries such as Germany, France and Spain, Ireland uses a system of joint taxation for married couples (See O'Donoghue and Sutherland, 1999). This system allows married couples to combine their income for income tax purposes. Spouses can transfer unused bands (and also some tax allowances) between each other to minimise their income tax liability.

In 2000 the intention was announced to move to an individualised income tax structure. This process is in transition at present. Rather than completely transferable individual tax bands, different family types such as lone parent, single earner couples and double earner couples have increased standard rate tax bands. It is therefore similar in some respects to the Spanish type joint tax system. In addition, a tax credit targeted at carers was introduced.

Peculiarly to Ireland, the income tax schedule changes for those with low incomes. The objective is to take low earning individuals out of the tax net. Figure 1 outlines the difference between tax allowances and tax exemption limits, where the straight line indicates the operation of the existing system, the dotted line the operation of the exemption limit and the crossed line the operation of marginal relief.¹³ The exemption limit effectively increases the zero rate tax band. However, in order to avoid the tax kink indicated by the dotted line, marginal relief is used to smooth this transition. Therefore, tax is paid at the marginal relief rate until it is equal to tax paid under the existing system. Tax exemption limits themselves are administratively quite simple and are a cheaper way of keeping people out of the tax net than tax allowances.¹⁴ However they do so at the cost of increased marginal income tax rates. Because of this issue although not abolished, below inflation increases has seen their

value fall from about 30 per cent of the average wage in 1980 to less than 20 per cent today so that for employees of working age they effectively are not used any more, remaining more as a mechanism for keeping elderly people out of the tax net.

Summing up the effect of all these changes, figure 2 highlights the operation of the income tax system between 1955 and 1998 for married couples with 2 children as a percentage of the average wage. We notice that income tax originally only applied to families with relatively high incomes; in 1955, a family had to earn more than 150 per cent of the average wage before tax was paid. Gradually then, the tax system was expanded, so that by 1973, those at about 50 per cent of the average wage paid tax. We notice also the increase in the average tax paid at each income level (here as a proportion of the average wage) increasing for all income tax paying levels of income until 1987. Since then reforms have been instituted which have resulted in the average tax rate falling back until the average income tax levels in 1998 are similar across all incomes to the level in 1980.

4.4 Social Insurance System

The current Irish social insurance system was established in 1951, combining a number of existing systems. In 1955, the only contingencies covered by the social insurance system were short-term disability, unemployment and widowhood. Over time, the range of contingencies covered has expanded with the addition of maternity (1953), old age (1961), retirement (1970), deserted wives (1974), long-term invalidity (1974), male survivors (1994), deserted husbands (1997) and carers (2000).

The coverage of the social insurance system has expanded substantially since the 1950s (see table 2). Initially full coverage was limited only to full-time private sector employees, with partial coverage of public sector workers. In addition until the 1970s, non-manual workers earning more than the contribution ceiling were excluded from membership of the social insurance scheme. This resulted in 1955 in a situation with coverage for only about 60 per cent of the work force, with full coverage for just over half (Hughes, 1985). Over time, the proportion of the work force in private sector non self-employed employment has increased, resulting in a gradual increase in the insured population. By 1973 73 per cent of the population were coverage. A number of further structural reforms have resulted in increased coverage. In 1974, the contribution limit was lifted for non-manual workers, increasing total coverage to nearly 85 per cent in 1975. The main effect of this reform was to nearly double the coverage for partial benefits within the public sector. Recent structural reforms have further increased coverage, including the extension of partial cover to the self-employed with earnings over a threshold in 1988. Part-time workers were included in the system in 1991. New public sector workers from 1995 are covered for all benefits. In recent years, the dominant force in the expansion in the numbers covered by the social insurance system has been demographic and economic as both the working age population and the labour force has increased dramatically in size. This is witnessed by the doubling of the insured population in the years, 1980-1998 and the continued increase to 2002.

Despite these reforms, until recently there had been a number of significant gaps in coverage. In 1998, only 75 per cent of those covered were covered for all benefits, with the rest being made up of self-employed, low-wage workers and existing public sector workers. Also there had been a number of groups completely excluded from coverage. Those within the labour market excluded from membership include those earning less than the contributory threshold, the self-employed in receipt of unemployment assistance, some participants on social employment programs and relatives assisting self-employed.

There is also a substantial proportion of the population not participating in the labour market, such as those in education or with home or caring responsibilities. Until 1994, unlike in countries such as Britain and Germany, those in with caring responsibilities were not credited with contributions during most of these periods. Therefore they would have been dependent upon their family or if their family is poor, state means tested benefits in retirement. However since 1994, carers of children aged under 6 and since 1995 aged under 12 or incapacitated, have the number of contributory years reduced up to a maximum of 20 years when calculating long term benefits. This policy is similar to Home Responsibilities Protection (HRP) in the UK. HRP is however more generous in that carers can get credited contributions as long as they are in receipt of child benefit payable to families with children aged 16 or under or in secondary education up to the age of 18. In addition in Ireland, one can only receive these credits if the carer has worked at some point. While it may be argued that when children reach the age of 12, carers can return to the labour market, such long periods out of the market may reduce their ability especially during a downturn to make that transition.

Credited Contributions are automatically for claimants of Unemployment, Disability and Maternity Benefits and Invalidity and Retirement Pensions. Recipients of Unemployment Assistance, Pre-Retirement Allowance, Injury Benefit, Carer's Allowance, or while participating in a Back to Education Programme or on a state training courses must have worked and paid at least 1 PRSI contribution in either of the previous two complete income tax years before making the claim. Students who have paid insurance contributions before entering University are also received for periods in education.

As we shall see below, because the insurance principle is so weak within the system, it is hard to justify that individuals, who have worked before receiving a benefit, caring or studying, can be entitled to credits while those who do not have recent work histories do not. Crediting contributions for these groups would be akin to the introduction of a basic participatory income for pensioners where entitlement to old age pensions would be based upon participation. Consideration may also be given to groups who are only partially covered by the social insurance system.

Turning to the structure of benefit payments, benefits have generally consisted of a flat rate payment (that varies by contingency) and unrelated to previous earnings,

with extra payments for dependants.¹⁵ Long term benefits typically also vary to a small extent by the number of contributions paid.¹⁶ Extra payments are also payable for those living alone and those aged 80 or more.

Contributions have moved from flat rate payments, which existed until 1978 to firstly a partially earnings related system in 1974, to a wholly earnings related contributory system in 1979, *Pay-Related Social Insurance* (PRSI). Total contributions are divided between employee and employer contributions that are paid into the social insurance fund and income levies paid into general taxation. PRSI is paid by workers on earnings up to a ceiling subject to an allowance that varies for different types of workers. Income over the ceiling faces a marginal rate of zero. Employer contributions (ERSIC) for employees have a similar structure except for employees with earnings below the ERSIC reduced rate limit, who face a lower ERSIC rate. Flat rate Health Contribution Levies, and Education and Training Levies are also paid by individuals with earnings above the exemption limit. This movement from flat rate benefits and contributions to flat rate benefits and earnings related benefits have resulted in a social insurance pension system thus is highly redistributive, reducing the pure insurance element of the system.

Figure 3 highlights the trend in the system of social contributions over the 1955-1998 period. In 1955, 1965 and 1973, social contributions were flat rate, not varying with income until the upper earnings ceiling was reached.¹⁷ At this, level workers paid no social contributions. Both the ceiling as well as the payment as a percentage of the average wage increased by 1965. This ceiling fell back by 1973, so that those on the average wage paid no contributions. We notice in 1980 the impact of introducing pay related social insurance (PRSI) over the 1970s. Those on very low pay were excluded, while PRSI was paid proportionally to income until the upper earnings limit was reached. At which point, the marginal rate drops to zero. The introduction of the income levies, resulted in the highest average rates being paid in 1987. By 1994, low wage earners were made exempt from these levies and were extended to cover higher earning workers on all incomes. The introduction of a PRSI allowance and the reduction of the marginal rate reduced the PRSI rates by 1998.

4.5 Non-Contributory Benefits

Like social insurance benefits, social assistance benefits in Ireland are contingency based, with most contingencies being covered by the system.¹⁸ Means-tested benefits in Ireland are relatively more important than in most other industrialised countries. Part of the reason is a result of the structure of mainly flat rate social insurance benefits. Earnings related insurance benefits will tend to have higher payments and thus correspondingly reduce the means tested benefits as a proportion of total benefits. This is only part of the story however. Much of importance of social assistance results from gaps in the coverage of social insurance. In addition to those who are not actually covered by social insurance at all, many such as the long term unemployed exhaust entitlement to insurance benefits and become reliant on assistance. Another source includes contingencies that are not covered by insurance

such as lone parenthood and low income if in work. Also in the past, the insurance system did not cover the contingency of old age and thus due to the relatively late introduction of social insurance pensions, many elderly people are reliant on assistance. Another source of assistance expenditure is as a farming support, as witnessed by the substantial numbers of farmers on low income receiving smallholder's unemployment assistance. Finally, relatively high benefit rates compared with say the UK (See Callan, 1997 and Eardley et al., 1996) result in the higher average expenditure.

Benefits can be classified into five types of cash payments, out of work payments, in work benefits, universal child benefits and housing benefits. There are also a number of in-kind benefits provided under the social assistance system including butter vouchers, fuel allowances and free transport payments for extraordinary expenses.

4.6 Out of Work Benefits

Most contingencies such as unemployment, old age, survivorhood and disability were covered by the assistance system at the start of period we are studying. A number of other contingencies were added over time including deserted wife's (1974), lone parents (1973), early retirement (1994) and carers (1994). More recently, a number of benefits have been introduced to assist in reintroducing the long-term unemployed to work.¹⁹ Contingencies not covered by the above payments are met by the Supplementary Welfare Allowance.

Like the social insurance system, if an individual is entitled to a means tested benefit then they will be entitled to a personal rate for themselves as well as possible additional payments for adult and child dependants.²⁰ In addition elderly recipients are entitled to extra payments if they live alone or are aged over 80. The total amount of benefit paid depends on a means test. In general, the unit of assessment used for means is the nuclear family. This unit is narrower than the household and as a result individuals living in households at the top of the income distribution may be eligible for social assistance. Therefore, social assistance may be less redistributive at the household level than would be expected under a household level means test (See O'Donoghue and Evans, 1999 for a discussion). An exception is in the case of unemployed people, where the income of people with whom they share accommodation can be counted as means (See Callan et al., 1996).

Means tests can be classified into four generic types used in unemployment assistance (UA), old age assistance (OANCP), lone parent (LPA), carers allowance (CA) and dependent payments means test.²¹ In general, incomes counted towards means include all sources of earnings, imputed income value of assets (See O'Donoghue, 1998 for a description).²² Social welfare incomes do not count as means. The five types are described as follows:

The UA means test depends on income net of taxes and contributions and a small earnings disregard.²³ Recently the withdrawal rate has been reduced from 100 per cent to 60 per cent on the recipients own income. Recently also the means test

applied to spouses income has fallen from 100 per cent to about 50 per cent, subject to an earnings disregard.

The Old age means test depends only on gross income. The withdrawal rate is 100 per cent while both spouses have a disregard of £6 pw. As both spouses can be eligible in their own right for OANCP, if a spouse receives the benefit individually, then their means are half the sum of both spouses incomes.

The lone parent means test has changed in the late 1990s in an effort to encourage increased labour force participation. It moved to a net income basis and from a withdrawal rate of 100 per cent to 50 per cent. In addition, the earnings disregard has been significantly increased.

The Carer's means test is based on net income, has a withdrawal rate of 100 per cent and has a small earnings disregard per child.

A spouse of a benefit recipient can have income up to a limit with the couple still receiving an extra payment for the spouse. Until the late 1990s, if the income exceeded this amount then the dependent adult payment and half of any child payment was withdrawn. Now, these extra payments are gradually withdrawn.

The operation of these means tests in 1998 is shown in Figure 4 for families with 2 children.²⁴ The graph plots gross earnings as a percentage of the maximum value of each particular benefit versus the benefit as percentage of this maximum. Therefore the actual value of the X axis will be higher for higher valued benefits such as Old Age Non-Contributory Benefit (OANCP). Also all means tested benefits at zero earnings will be 100 per cent of the maximum.

Here, we notice the attempt to reduce the disincentives to work inherent in the system. In 1994, the means test for Unemployment Assistance was similar to the Carer's allowance (lines with squares), where the benefit was largely withdrawn pound for pound with net income. In the intervening period, a lower withdrawal rate of 60 per cent was introduced (dotted line), so that the benefit in 1998 is not completely withdrawn until income reaches just over 250 per cent of the maximum value of the benefit.

The changes made to the Lone parent benefit means test (dark line) have even been greater. Here the test moved from a 100 per cent withdrawal rate based on gross income (like the Old age assistance means test (lines with crosses) to a means test based on net income with a withdrawal rate of 50 per cent. Also a larger income disregard was included as seen by the flat section for those on low benefits. In 1998, one-parent families could then earn £6000 per year without their benefit being affected. This combined with the more generous taper, means that the benefit would not be fully withdrawn until earnings reached over 400 per cent of the original benefit.

Finally, we notice the impact of a spouse of an unemployed person earning in UA Spouse (Circled Line). Here, we notice that after a short period where income is disregarded, the spouse extra payment (and half the child payment) is rapidly withdrawn. By the time the working spouse earns 80 per cent of the UA, the benefit received becomes less than UA received if the working spouse had been the one claiming the UA (the dotted line) as part-time workers can claim UA, however the

benefit is assessed for the family. At this point perversely, it would make more sense to shift the claim from the “unemployed” spouse to the working spouse.

4.7 *In-Work Benefits*

The Family Income Supplement is a payment to those who are in work, is similar to Family Credit (now Working Families Tax Credit) in the UK and Earned Income Tax Credit in the USA, and was introduced in 1984. It is payable to families with children who work more than a certain limit. In 1994, this limit was 20 hours per week, reduced from 24 hours per week in 1987.²⁵ All gross income (before tax or social insurance contributions are subtracted) including earned, unearned and transfer income is counted as means.²⁶ Families with income below certain limits, dependent on the number of children, are entitled to FIS if they meet the conditions set out above. The amount of FIS payable is 60 per cent (up from 50 per cent in 1987) of the difference between the limit and family gross income, subject to a minimum payment.

Callan et al (1995) examined the impact on the marginal effective tax rate of the interaction of FIS with other instruments such as income tax and social insurance contributions. Recommendations resulting from this report resulted in the income base for Family Income Supplement moving from pre-tax and contribution income to net income in 1996. This is highlighted in figure 5, which takes the FIS in 1994 with 4 children and simulates a budget constraint for a family with 4 children. In the system based on gross income (black line), we notice the severe poverty trap faced by the family, caused by the interaction of income taxes, social insurance contributions and FIS. Here income after FIS actually fell from around £8500 p.a. to £13000 p.a. Moving to a net income base reduces the effect of the poverty trap.

4.8 *Housing Benefits*

The housing benefit scheme in Ireland was introduced in 1977 under the act that instituted the supplementary welfare allowance (SWA) (See DSW, 1995). It covers rent, mortgage interest and household insurance. According to DSW (1995), “*the SWA scheme was originally devised so as to provide a residual and support role within the overall income maintenance structure by guaranteeing a standard basic minimum income and by assisting those confronted with exceptional needs. However the increase in the volume of rent and mortgage supplementation in recent years has affected this role.*” In 1995, 36,700 people were in receipt of the benefit split 30000 covering rent (one third of the private rented sector) and 6700 for the mortgage interest. As the means tests described above there is only limited information available about the actual structure of these housing benefits.²⁷ Firstly, all families regardless of income are responsible for part of their housing costs (about 10 per cent of value of SWA). Housing allowances cover remaining housing costs up to a limit which depends on the family composition and location. Families are allowed disposable income equivalent to the SWA, before they have to make any further

contribution. Pre-tax income above this amount is withdrawn at a 100 per cent withdrawal rate.

5. ASSUMED NEED: IMPLICIT EQUIVALENCE SCALES 1955-2002

In the last section, the rules of the tax-benefit system were described. Here, we examine how changes over time influence trends in needs implicit in the tax-benefit system; the weight placed by the system on the extra costs resulting from the existence of dependants. To do this we consider the concept of implicit *equivalence scale* within the system. In other words, the extra percentage of benefit or tax allowance received relative to the amount received if they were single. Except in the case of social insurance where both spouses are entitled in their own right, benefits (and taxes until 1980) apply to the family level. However even in the case of social insurance, if only one spouse is eligible then these instruments too apply at the family level. In other words a member of the family applies for the benefit or pays tax and they get extra payments or allowances for their dependants.

Table 3 presents the trend in the equivalence scale for the main benefits and income taxation for adult dependants and the first child dependant, from 1955-2002. With regard to benefits, we notice the biggest change between 1955 and 1965, where the ratio of benefits given to dependants relative to the claimant rose dramatically. For adult dependants, the ratio increased in each case by over 40 per cent from about 0.5 to 0.71-0.81.²⁸ Since then, there has been a gradual decline in the adult dependant equivalence scale to 0.58-0.68 in 1998. However, in the 2000 budget it was announced that it was intended to bring this equivalence scale up to 0.7 again and so by 2002 the adult equivalence scales rose again. The child-dependent equivalence scale shows a similar movement, with a particularly large fall in the equivalence scale 1980-1987. Since 1994, the child dependent amounts have not increased in nominal terms, as it has been government policy to increase universal child benefits instead and so equivalence scales have steadily fallen. This is because of the disincentives to work for unemployed persons with children.

6. INCOME REPLACEMENT

Looking at equivalence scales allows us to examine the need implicit across different family types for specific contingencies over time. However, it does not allow us to compare between benefits or the value of the instrument relative to the standard of living. Also by focusing on only one instrument it ignores the interaction between instruments.²⁹ Net Replacement rates, which are the ratio of out-of-work to in-work income allow us to do both. With a fixed denominator in a particular year (net average earnings), we can compare between benefits. Thus, higher replacement rates indicate higher benefits. Meanwhile a falling replacement rate over time indicates that the benefit has been falling behind earnings over time.

Table 4, describes the trend in the net replacement rate from 1955-2002. For single persons, replacement rates in general are quite low by European standards, with the replacement rate never reaching 40 per cent, in most cases never reaching 30 per cent, with the lowest replacement rate being 10 per cent in 1955. As the objective of social benefits in Ireland has generally been one of poverty alleviation rather than income replacement, we see that there is provision for dependants. We notice a very dissimilar trend to that observed for equivalence scales. From 1955-1965, we observe a fall in the replacement rate, despite an increase in equivalence scales over the period. This is because single person benefits in general fell with respect to net average earnings and thus despite the increase in the proportion of the benefit relating to dependants replacement rates for families with 2 children fell. By contrast, despite falling equivalence scales for dependants, the replacement ratio rose from 1965 to 1987. This is partly to do with rising benefit levels and partly to do with higher taxation, which reduces the denominator, net average earnings.

Since 1987, falling taxation has resulted in higher denominators, pushing replacement rates up. The most important effect over the period however has been a shift from highly variable replacement rates for different contingencies to a more equal distribution of benefits. This has been accomplished primarily by increasing the lowest valued, mainly short-term and assistance benefits at a faster rate than the others. In 1985, the Commission on Social Welfare (CSW, 1985) recommended a minimum level of benefit to achieve a basic standard of living. By 1999, this had been achieved for all benefits. However despite this achievement, the level of indexing since 1987 has seen benefits over the last 15 years fall further behind earnings, despite rapid economic growth. Between 1998 and 2002, this trend continued with the exception of a number of longer term benefits, where the trend was reversed. This, in the periods of lower growth, will reduce the ability to meet another target as part of the National Anti-Poverty Strategy, that relative poverty (as measured by 60 per cent of average income) fall from 15 per cent to 10 per cent by 2007.

7. SOCIAL INSURANCE VERSUS SOCIAL ASSISTANCE

Section 5 highlights a reduction in the insurance principle within the tax-benefit system. Until the 1980s/early 1990s, contributory benefits were much more generous than assistance benefits. However a deep recession during this period and a concern about the adequacy of some benefits, has seen the higher valued insurance benefits increase at a slower rate than assistance rates. In addition, increasing numbers of people depend on assistance income over long periods. Other changes, which have highlighted the reduction of the insurance principle, include the movement from flat rate contributions and benefits to earnings related contributions and flat rates benefits.

Another difference between the operation of public schemes and private savings mechanisms relates to the link between the amount of contributions and benefits

received. Social insurance payments for retirement, old age and invalidity depend only on the number of contribution paid or credited.³⁰ However, again this link is quite tenuous, as the difference between minimum and maximum benefit levels is very small. Individuals with on average 20 contributions per year receive pensions of about 95 per cent of those with maximum contributions (48 per year).³¹ Recently the minimum number of contributions has fallen to 10 per year where a reduced pension of 50 per cent of the maximum is payable, strengthening slightly the insurance principle. Although most recipients get the maximum rate, significant numbers receive less than this; in 1995, 38 per cent, 41 per cent and 11 per cent respectively received less than the maximum payment of the old age, retirement and survivor's pensions.

This emphasis on poverty reduction rather than income replacement means that for higher earning families, the social welfare system does not provide sufficient income for retirement and long-term illness. Therefore, private provision of income replacement mechanisms for retirement and long-term illness is quite important with about half of all workers covered for these risks. While this is high by international standards, coverage of earnings related savings instruments amongst the working population is low by international standards, where most OECD countries have some form of earnings-related pension plans.

The reforms to pension provisions since the early 1990s have been designed to improve the portability and coverage of pensions, in particular the introduction of Personal Retirement Savings Accounts (PRSAs) and the increased tax relief available for individuals to increase their contribution rate as they get older. In the UK, the introduction of Stakeholder Pensions has been met by a limited interest especially by the groups least likely to have their own private pensions. Part of the reason are low returns available on financial instruments, but also the low charge that providers can receive, limited to 1 per cent of contributions. Many firms have therefore stopped marketing these products to low income groups. The PRSAs have higher maximum charges at 5 per cent of contributions and 1 per cent of assets. However contribution rates of this order are still low (€12 per year for an individual who makes monthly contributions of €50) and so Ireland may have similar problems. Some degree of compulsion or state provision may be necessary to improve the retirement income provision across all income groups.

8. INTERACTING INSTRUMENTS IN THE TAX-BENEFIT SYSTEM

Having described the main features of the system, we now pull the strands together to consider the system as a whole. We shall firstly describe the interaction of the different components before comparing the impact on different types of families, different annual systems and the impact of new back-to work incentives.

Figure 6 describes how the different income components of the 1998 system interact to produce disposable income for a single earning married couple with 2 children on

the minimum hourly wage.³² The grey band represents child benefits, the white band unemployment benefits, the check pattern, family income supplement, the horizontal stripes earnings after taxes and contributions and the black band housing benefits. We notice first that as universal benefits, child benefits do not vary with income. Unemployment Assistance (UA) is withdrawn until 3 days work (24 hours pw) has been reached. At this point the Family Income Supplement (FIS) is received. As the incomes are plotted cumulatively, the upper bound of net earnings represent pre-housing benefits disposable income. Except for a kink when a family moves from UA to FIS, disposable income rises with hours worked. The kink occurs because the value of UA at 24 hours of the minimum wage is greater than the equivalent value of FIS. Housing benefits being withdrawn pound for pound with disposable income result in a flat profile of final income, with a family having to work 70 hours at the minimum wage before disposable income exceeds that of a family not working. We shall see however that both these issues have been alleviated through the introduction of back-to-work benefits. In addition, housing benefits have in the past been relatively unimportant. Recently however, housing benefits have become more important and thus the disincentive effects have become more important. Currently, therefore the scheme is being examined to see if a less severe withdrawal rate could be introduced.

We now consider the treatment of different families. Figure 7 plots gross income versus disposable income per annum for 4 different family types (not receiving housing benefits), single, lone parent with 2 children, married couple with no children (MOK), and married couple with 2 children (M2K). The tax-benefit system is progressive for each type across the whole range of income. Married couples without children have higher disposable incomes than single people with the same earnings. For those receiving benefits because of the presence of adult dependant additional payments and for those higher up the income scale because of the existence of joint taxation, which reduces tax liabilities for the couple. Families with children married and unmarried have higher disposable incomes than families without children. Initially married couples with children have higher disposable income because of higher benefits. However, because of the more favourable means test as outlined in section 2, lone parents eventually receive more benefits. However married couples (with and without children) eventually pass the disposable income of the lone parent at about £25k p.a. because of their lower tax liabilities, again because of the existence of joint taxation.

We now turn to the trend in tax-benefit incidence over time. Figure 8 plots the budget constraint, a graph of disposable income versus gross income (as a percentage of the average wage), faced by married couples with 2 children for the period 1955-1998. At the bottom of the income distribution, we notice, the impact of rising benefit levels, especially 1955-1973 and 1987-1998. Also, we saw the effect of the change in the unemployment assistance means test, with flat disposable income in 1955-1987, as a £1 of benefit is withdrawn for every £1 of income. In 1998, this *poverty trap* has been eliminated as now disposable income rise with gross income. Above 50 per cent of the average wage, we notice the effect of the

rising tax burden 1955-1987, as the budget constraint is lower for each year examined. This trend has been reversed by 1998.

8.1 Redistribution over the Lifetime

In addition redistribution between different income groups at one point in time, the insurance system for example with earnings related contributions and flat rate benefits, redistributes from rich to poor over the lifetime. Therefore those with lower lifetime earnings will have higher returns (See Hughes, 1985).³³

Figure 9 compares the return of the tax-benefit system over a lifetime relative to a private savings instrument. In each case we consider the case of a single male earning varying proportions of the average wage. The graph reports the ratio of benefits received to taxes and contributions paid if they lived their entire life in a world where a particular years system applied.³⁴ Clearly, no individual lives in such a world, however the steady state assumption allows one to study the effect of each system in isolation. Assuming a growth rate equal to the interest rate, a private savings instrument in the absence of management fees would give a return equal to 1. For each of the tax-benefit systems examined, we notice the strongly redistributive nature of the system, where those who on average have lower incomes receive relatively more benefits than pay taxes. We also notice that much of the earnings distribution have returns significantly below 1. In fact, only in the case of 1998 and 1995, do we see returns in excess of unity for those with low average wages. For the other years, those with average lifetime earnings that vary from 40 per cent to 300 per cent of the average wage have returns below unity. We see a trend of falling returns from 1955 to 1973, before rising again to 1998. This effect is a result of a mixture of changes in taxes and benefits.

Examining men who remained single their whole life, never having children or experiencing spells out of the labour market between leaving education and retiring is quite an extreme case. The presence of spells out of work increases the redistributive effect even further for those lower down the income distribution. Also, working women who tend to have lower average wages, will on average have higher returns for the same number of years worked. However many women will not work sufficiently long to be eligible for benefits and thus in aggregate may in fact have lower returns. It is necessary to look at the distribution of lifetime incomes to consider this issue in more detail. Families who work for shorter periods will also have higher returns from the tax-benefit system. As noted above, although contribution related, the difference in benefit level for families with the maximum contribution record and the minimum contribution record is very slight. In any case, assistance benefit levels are not much lower than the lowest insurance pension level. Also as Hughes (1985) pointed out, those who were early recipients of the insurance pension had higher returns as they were required to have had lower contribution records. In addition, married couples and families with children will have higher returns due to the existence of adult and child dependent payments in the benefits system.

9. CONCLUSIONS

This paper outlines the main characteristics of the Irish tax-benefit system and describes the main trends in the components of the latter since 1955. The main forces driving the institutional reforms have been an expansion of *social rights* (O'Connell and Rottman, 1992), a greater degree of targeting to focus on poverty reduction culminating in the Anti-Poverty Strategy and a concern to improve work incentives.

Over the period, income taxes have gradually increased in importance, reaching a peak in the late 1980s before falling back during the 1990s. The social insurance and assistance systems have also expanded both in terms of the coverage of the population, the demand for benefits and the value of benefits. Again these trends levelled off in the 1990s.

9.1 Retirement Age

One of the main distinguishing features in the Irish tax-benefit system relative to other European tax-benefit systems is the almost complete absence of an insurance component in the benefit system. Although the largest benefit instruments are nominally called insurance benefits and depend on the payment of insurance contributions, the objective of these instruments are primarily redistributive (in the narrow sense of vertical redistribution) rather than income replacement. For about 15 years earnings replacement benefits were included for the unemployed and for the disabled. However these were gradually reduced in importance and finally abolished by the 1990s. However, for longer term contingencies such as old age, the provision for income replacement is left to the private sector. The introduction of an earnings related element into the state pension system however has been examined periodically over the last thirty years. In 1976, the government issued a discussion paper which recommended the introduction of an earnings related scheme on the basis that the existing scheme could not meet the income needs in retirement of many people (Department of Social Welfare, 1976). In 1984, the government announced plans to publish a plan for a national pension (Ireland, 1984). This was never published due to the establishment of the National Pensions Board who subsequently analysed a proposal for such a scheme (NPD, 1993). They however recommended that a state income related pension should not be established due to the potential impact on competitiveness and employment and also due to a lack of research into the adequacy of the existing flat rate pension in maintaining in work incomes. However given a decline and subsequent levelling off at about 50 per cent of the working population in private pension coverage rates, there may be a case for this.

The existence of the retirement pension where payment is dependent upon the withdrawal from the labour force at 65 is another retirement related issue. It goes against the policy in most OECD countries of promoting more flexible retirement,

especially given impending dependency rate problems. In fact consideration may be given to actuarially increasing state pensions for those who postpone retirement until later.

9.2 Working Age

In this paper, we have noticed the gradual change in the tax-benefit structure over the last 20 years in order to improve work incentives. Firstly the family income supplement was introduced to negate the *unemployment trap*, created by the value of unemployment benefits relative to in work incomes for families with children. This however introduced a *poverty trap* further up the income distribution as families faced a withdrawal rate of over 100 per cent (see Callan et al., 1995). As a result, the means test for FIS was made dependent upon income after taxes and benefits. This reform was effective in eliminating the poverty trap resulting from FIS. However around the same time effort was made to reduce the poverty trap faced by those on unemployment assistance who faced a 100 per cent withdrawal rate. Moving to a 60 per cent withdrawal rate for this benefit has eliminated this poverty trap, which in turn reintroduces the poverty trap for those on FIS as a family working 24 hours per week on UA will receive more than a family working 25 hours per week on FIS. The back to work allowance (BTWA) removes this poverty trap for 3 years, but however for families who have to rely on the minimum wage, the long term poverty trap. Lastly the increased reliance on housing benefits with its 100 per cent withdrawal rate further exacerbates these problems. This process of temporary responses to particular problems in the system has resulted in one of the most complicated benefit systems in Europe.³⁵ This level of complexity, besides the in built poverty traps, causes itself negative behavioural disincentives. At one extreme the complex benefits system reduces the likelihood that families will claim the benefits they are entitled to. At the other extreme, families will spend so much time claiming the benefits they are entitled to that they may not have time to look for work.³⁶ It is therefore time, to carry out extensive coordinated reform of the entire system.

Endnotes

1. Although as noted below Pay-Related Benefits did exist for a period 1974-1994.
2. This feature is being abolished from the 2000 budget.
3. In relative terms, these are much less important than in other European countries.
4. The sources used for this section are annual reports of the Revenue Commissioners and the Department of Social Welfare and Budget Statements of the Minister of Finance over the period 1955-2002.
5. See O'Donoghue and Sutherland (1999).
6. See Callan and Van Soest (1995) for a discussion of the impact of individualising the income tax on labour supply.
7. Deductions allowed at the standard tax rate operate in a similar way to Credits.
8. This assumes that taxes paid exceed the value of the credit or allowances.
9. This rate assumes that individuals are at the average wage.
10. Ferrera (1996) uses this argument to rationalise the structure of tax-benefit systems in Southern Europe, where targeting of resources is achieved through instruments that have the administrative capacity such as income taxation or social insurance.
11. The main exception is a lone parent allowance introduced in 1980 and a dependent relative allowance and now credit.
12. Capital gains and bequests are taxed separately.
13. Note the tax schedule used here is a hypothetical one, and is not representative of the Irish system. It is used simply for illustrative purposes.
14. However once income exceeds the exemption limit and marginal relief is paid, then they are administratively more complicated.
15. For a period from the late 1970s to mid 1990s, there existed a small earnings related component in Unemployment and Disability Benefits. Subsequently, a component has been retained so that benefits are adjusted to limit the replacement rate of those with very low previous earnings. Maternity benefits continue to be earnings related subject to maximum and minimum payments.
16. The relationship between the number of contributions is quite tenuous as, for example, an average of 24 weeks of contributions per year, entitles a single person to a pension of 94 per cent of the maximum retirement pension received for an average 48 contributions per year. Also for no extra contribution, additional payments are made in respect of adult and child dependants of the claimant. The TWIG Report which showed that in 1991/92, 37 per cent had a mixture of contributions and credits and a further 29 per cent had credits only, strengthening the point about the tenuous link between contributions and benefits (Source: personal communication with Donal de Buitlir).
17. This ceiling existed for non-manual workers.
18. The excluded categories are those who, although capable of work, do not seek employment including those in education.

19. Benefits include the Back to Work Allowance, the Part-time Job Incentive Scheme, the Back to Work Enterprise Allowance and the Back to Education Allowance.
20. An exception occurs if both individuals are entitled to the Old Age Non-Contributory Pension. In this case both will be entitled to the full personal rate, rather than a personal rate payment and an adult dependent payment (See Callan et al, 1996).
21. See Callan et al. (1996) and Callan and Nestor (2000) for a description of these means tests.
22. There is also a capital means test (See Department of Social and Family Affairs Website, www.welfare.ie). This too has had a recent reform, where a substantial capital allowance was introduced to promote saving.
23. Allowable on a claimant's own income if no children are present
24. All families except for the lone parent benefit/one parent family benefit are assumed to be a married couple.
25. In the case of two parents living together, their hours worked could be added to reach this limit.
26. The principal exceptions are child benefit, carer's allowance, domiciliary care allowance and rent allowance.
27. See Callan and Nestor, (2000) and DSW (1995).
28. Recipients of old age assistance payments are entitled to apply individually in their own right and thus the adult dependant equivalence scale has remained constant at 1 over the entire period.
29. As in general an individual can only apply for one benefit, the only type of interaction possible would occur if both spouses in a couple were eligible for separate benefits in their own right. In this case The numerator would be higher. At the same time, one might expect that one should consider a higher denominator as one would then be looking at the replacement rate of two income replacement rates and thus should include two wages in the denominator.
30. Payments of invalidity to under 65s are, however, at a lower rate.
31. More generous contribution records are required for the survivor's pension.
32. It is assumed that they pay a private sector rent of £105 pw.
33. This effect is reduced because of the existence of an upper earnings limit.
34. We assume that the system is neutral and so subtract taxes that are used for other non benefit expenditures.
35. An example of this complexity is that in the Europe-wide Tax-Benefit model partially written by the author, the Irish benefits module takes longer to carry out a calculation than any other countries benefit system.
36. In Dublin city a family who is unemployed has to sign on the unemployment register at the Department of Social Welfare to receive unemployment benefits, go to the health board to claim heating vouchers, visit the community welfare officer to receive housing allowances, the city council to deal with social housing claims, the training and employment authority to seek work and finally to the post office to receive the actual benefits!

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APPENDIX: TABLES AND FIGURES

**Table 1: Irish Tax-Benefit System: Revenue and Expenditure 1955-2001
(as percentage of GNP)**

	1955	1965	1973	1980	1987	1994	1998	2001
<i>Universal</i>								
Child Benefit	1.0	1.0	1.2	0.8	1.2	0.8	0.9	1.0
<i>Insurance</i>								
Ill	0.6	0.8	1.1	1.1	2.1	1.3	1.0	0.8
Unemployment	0.4	0.4	0.5	1.5	1.5	0.7	0.5	0.3
Survivor	0.3	0.5	0.8	1.0	1.2	1.0	0.9	0.7
Old	0.0	0.7	1.1	1.7	2.2	1.8	1.6	1.5
Other	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.5
Total	1.4	2.5	3.6	5.4	7.1	5.0	4.3	3.8
<i>Assistance</i>								
Unemployment	0.2	0.2	0.7	0.9	2.3	2.7	1.5	0.7
Survivor	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Old	1.8	1.2	1.2	1.6	1.6	1.0	0.8	0.6
Other	0.1	0.0	0.2	0.2	0.5	1.0	1.6	1.9
Total	2.4	1.7	2.4	2.9	4.6	5.0	4.1	3.3
All Benefits	4.8	5.2	7.2	9.1	12.8	10.8	9.3	8.1
<i>Tax and Contribution</i>								
PRSI	1.0	1.5	2.1	4.4	5.1	5.1	4.0	4.4
Income tax	4.5	5.4	8.2	11.2	14.3	12.3	10.7	9.4
Indirect tax	10.2	10.6	14.5	15.1	16.2	14.4	13.7	12.3
Household Sector Total	15.6	17.4	24.8	30.7	35.6	31.8	28.4	26.1
Corporation Tax	0.6	0.9	0.9	1.5	1.4	3.5	3.9	4.4
Other	5.0	6.8	5.8	7.0	2.4	2.7	2.0	2.7
Total	21.2	25.1	31.4	39.2	39.4	38.0	34.3	33.3

Source: Statistical Abstract, Central Statistics Office, *various years*.

Table 2 Coverage of Social Insurance and Income Taxation: Thousands of Participants

Year	Total Making Employee Income Tax Returns	Total Insured	Workers Fully Covered	Workers Partially Covered
1955		726	639.2	86.8
1965	384.1	744	671.2	72.8
1973	700.0	815.7	742.9	72.8
1980	1477.9	1023.4	837.3	186.1
1987	1328.3	1343.2	1103	240
1994	1772.2	1769.9	1322	448
1998	2467.4	2106.8	1574.3	532.5
2000*	2663.3	2407.3	1787.1	620.2

Sources: 1. Reports of the Department of Social Welfare, various years;
 2. Statistical Information on Social Welfare Services, various years;
 3. Statistical Report of the Revenue Commissioners, Hughes (1985)

Note: *1999 for Income Tax Participants.

Table 3 Equivalence Scales Additions for Dependents

	Adult						Child									
	1955	1965	1973	1980	1987	1994	1998	2002	1955	1965	1973	1980	1987	1994	1998	2002
Unemployment Benefits	0.50	0.71	0.65	0.65	0.65	0.60	0.58	0.66	0.27	0.31	0.28	0.29	0.23	0.22	0.19	0.14
Unemployment Assist.	0.56	0.81	0.73	0.72	0.72	0.62	0.60	0.66	0.22	0.35	0.31	0.34	0.24	0.22	0.19	0.14
Supp. Welfare Allow				0.73	0.62	0.60	0.60	0.66				0.25	0.22	0.22	0.19	0.14
Short Term III Contrib.	0.50	0.71	0.65	0.65	0.65	0.60	0.58	0.66	0.27	0.31	0.28	0.29	0.23	0.22	0.19	0.14
Old Age Contrib.	0.00	0.79	0.65	0.64	0.75	0.72	0.69	0.78	0.00	0.22	0.26	0.26	0.20	0.18	0.18	0.13
Old Age Assistance	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.00	0.42	0.27	0.27	0.20	0.22	0.18	0.13
Long Term III Contrib.				0.65	0.47	0.60	0.64	0.72				0.29	0.17	0.22	0.21	0.16
Long Term III Assistance				0.60	0.57	0.60	0.66	0.66				0.32	0.19	0.22	0.19	0.14
Survivor's Contrib.									0.27	0.34	0.33	0.33	0.26	0.26	0.23	0.15
Survivor's Assistance									0.31	0.28	0.33	0.33	0.25	0.25	0.22	0.16
Lone Parent Assistance												0.33	0.25	0.25	0.22	0.16

Source: Author's calculations

- Notes:
1. The recipient of the benefit is assumed to be one equivalent adult and has the modal age for that benefit (e.g. does not receive additional payments for very old age or lower payments for being < 18). Certain long-term benefits also have additional payments for living alone, which is ignored here.
 2. Adult dependants are assumed to have the same age as the spouse. The payment for spouse can also vary by age.
 3. Child payments may also vary by number of children.
 4. All payments are assumed to be for households living in urban areas.
 5. Unemployment assistance is assumed to be for long-term recipients. Lower rates apply for short-term recipients.

Table 4: Out of work replacements rate (as percentage of average wage)

	Single										M2K									
	1955	1965	1973	1980	1987	1994	1998	2002	1955	1965	1973	1980	1987	1994	1998	2002				
Unemployment Benefits	17.6	15.3	23.9	25.5	30.1	31.0	28.6	27.2	34.5	31.3	48.3	52.0	57.3	58.6	52.0	53.4				
Unemployment Assist. LT	10.6	10.4	19.5	21.2	26.9	31.0	28.6	27.2	20.9	23.4	42.2	45.8	53.8	58.6	52.0	53.4				
Unemployment Assist. ST	10.6	10.4	19.5	21.2	24.2	29.9	27.8	27.2	20.9	23.4	42.2	45.8	49.4	57.6	51.3	53.4				
Supp. Welfare Allowance.	10.6	10.4	19.5	21.2	24.2	29.9	27.8	27.2	20.9	23.4	42.2	45.8	49.4	57.6	51.3	53.4				
Short Term III Contrib.	17.6	15.3	23.9	25.5	30.1	31.0	28.6	27.2	34.5	31.3	48.3	52.0	57.3	58.6	52.0	53.4				
Old Age Contrib.	0.0	21.6	26.3	30.6	39.2	36.1	33.7	33.7	0.0	42.0	51.6	59.9	78.0	75.4	68.3	66.2				
Old Age Assist.	14.1	17.1	22.5	26.2	33.5	31.0	29.4	30.7	27.5	33.3	51.8	60.4	71.7	69.3	63.4	66.5				
Long Term III Contrib.	0.0	0.0	0.0	27.5	34.5	31.8	29.3	28.2	0.0	0.0	2.9	55.8	64.6	63.1	55.8	57.0				
Long Term III Assist.	0.0	0.0	19.7	25.3	31.7	31.0	28.6	27.2	0.0	0.0	42.4	51.2	56.2	58.6	52.0	53.4				
Survivor's Contrib.	17.6	15.3	24.1	28.1	35.2	32.8	30.1	33.6	26.4	23.0	37.1	43.3	48.6	47.3	41.8	45.6				
Survivor's Assist.	13.2	12.9	22.5	26.2	32.9	31.0	28.6	27.2	21.2	16.9	34.7	40.3	45.7	44.2	39.3	39.6				
Lone Parent Assist.	0.0	0.0	0.0	26.2	32.9	31.0	28.6	27.2	0.0	0.0	2.9	40.3	45.7	44.2	39.3	39.6				
Gross Ave. Wage (Male)	7.7	13.8	36.0	112.4	237.1	298.4	349.1	537.8	7.7	13.8	36.0	112.4	237.1	298.4	349.1	537.8				
Net Ave. Wage	7.0	11.7	27.4	80.1	140.5	196.7	246.7	436.8	7.6	13.5	30.9	94.8	176.2	233.9	296.2	436.8				

Source: Author's calculations

- Notes: 1. M2K denotes married with two children, except in the case of single person payments such as lone parent and survivors' payments where it refers to those with two children.
2. Replacement Rates are net of taxes and other benefits such as child benefits.
3. ST means short-term and LT means long-term.

Figure 1 Exemption Limit and Marginal Relief (Married Couple 2 Children)

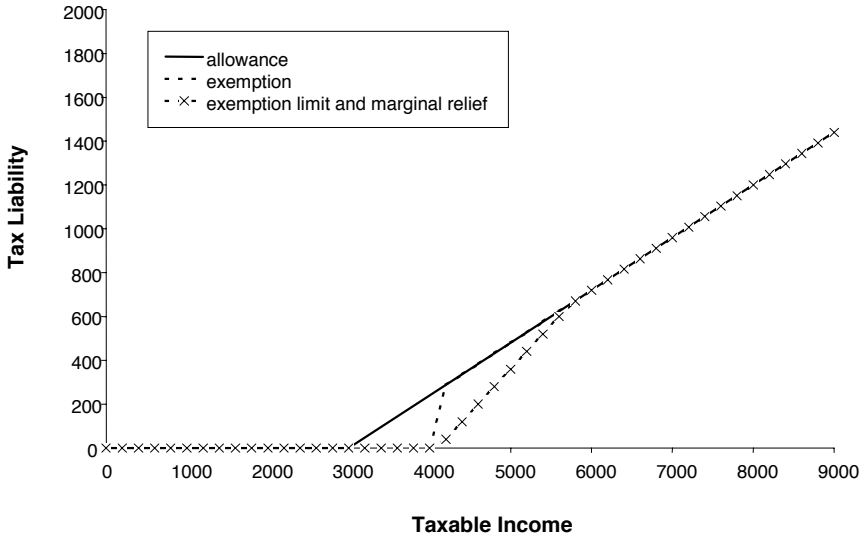
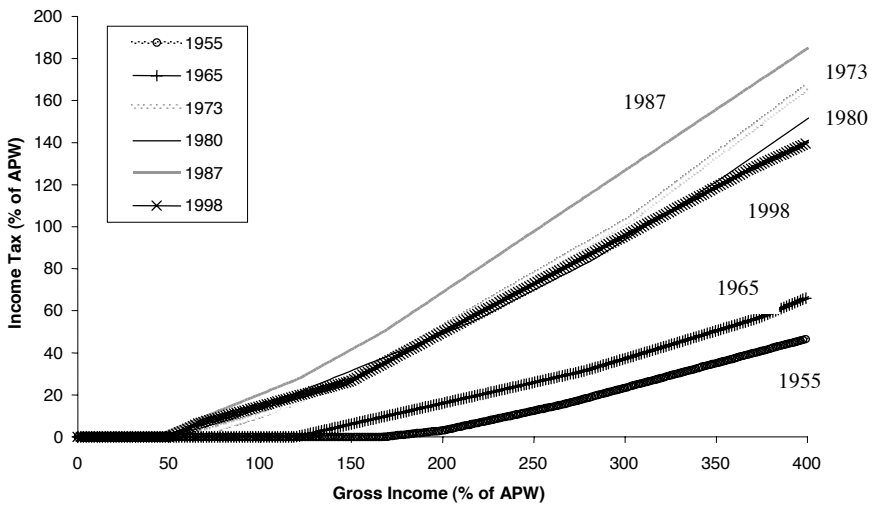
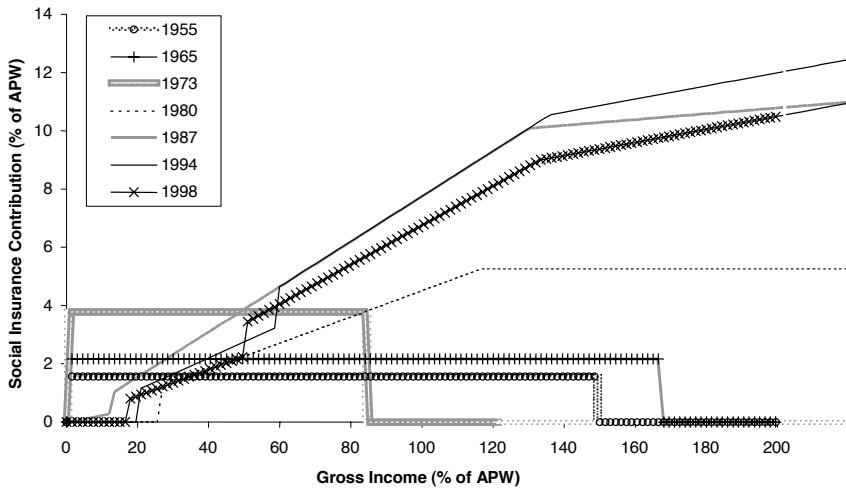


Figure 2 Income Tax 1955-1998 (Married Couple 2 Children)



Note: APW denotes Average Wage of a Production Worker

Figure 3 Social Insurance Contributions 1955-1998



Note: APW denotes Average Wage of a Production Worker

Figure 4: Means Testing of Social Assistance 1998

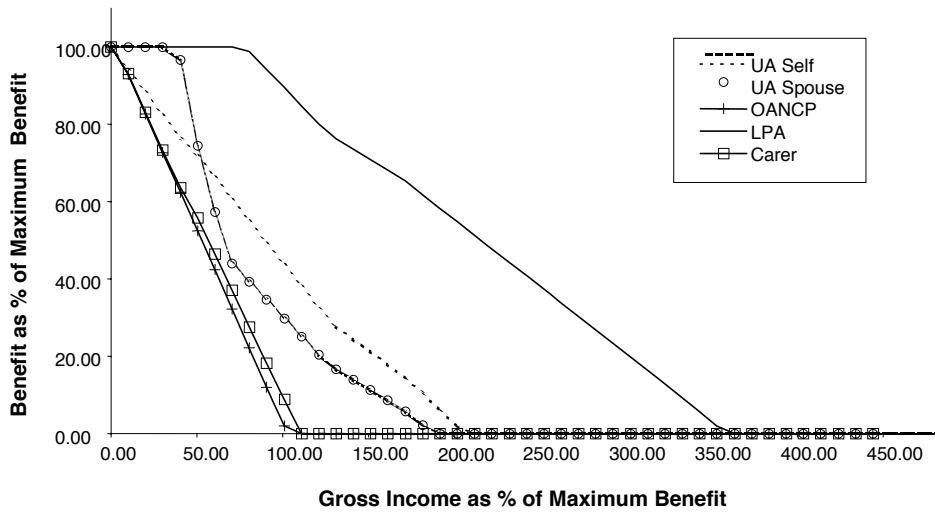


Figure 5 Family Income Supplement Reform

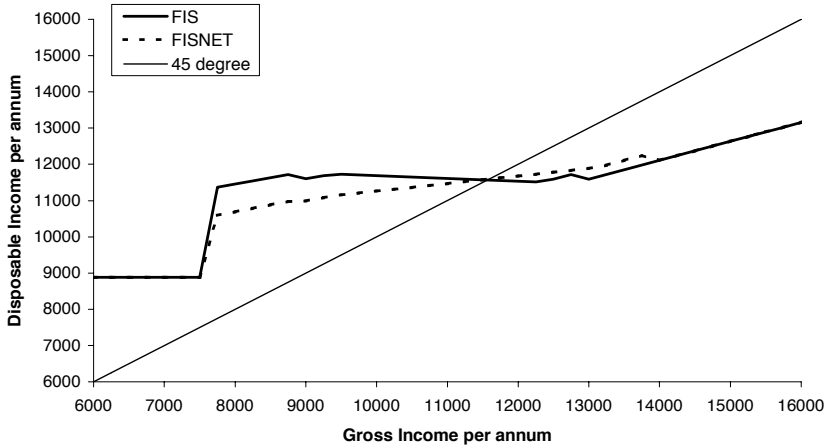
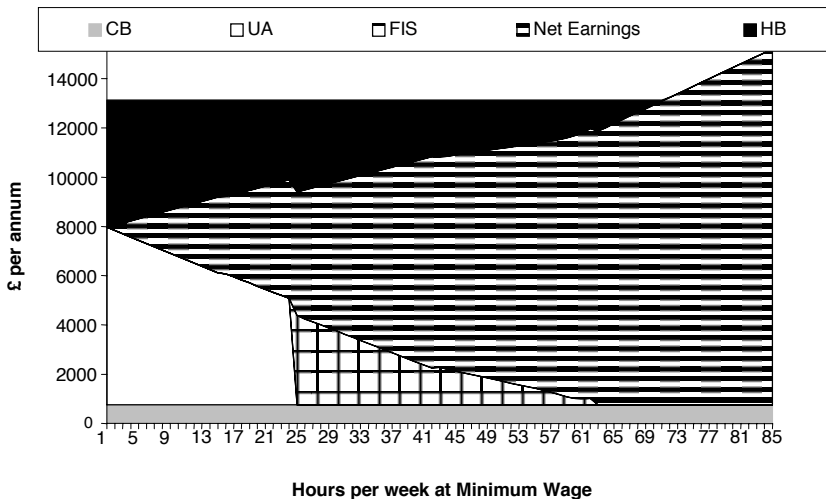
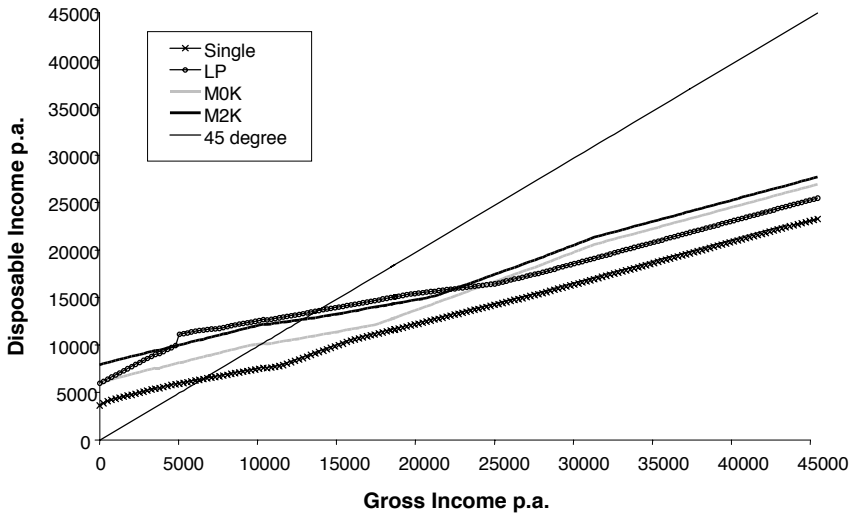


Figure 6 Interaction of different benefits 1998 (Married Couple with 2 children)



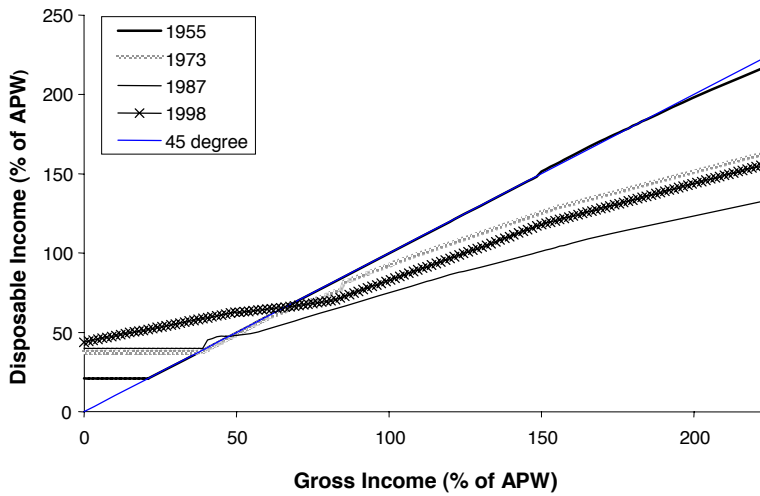
Source: Author's calculations

Figure 7 Irish Tax-Benefit System 1998. (No HB)



Source: Author's calculations

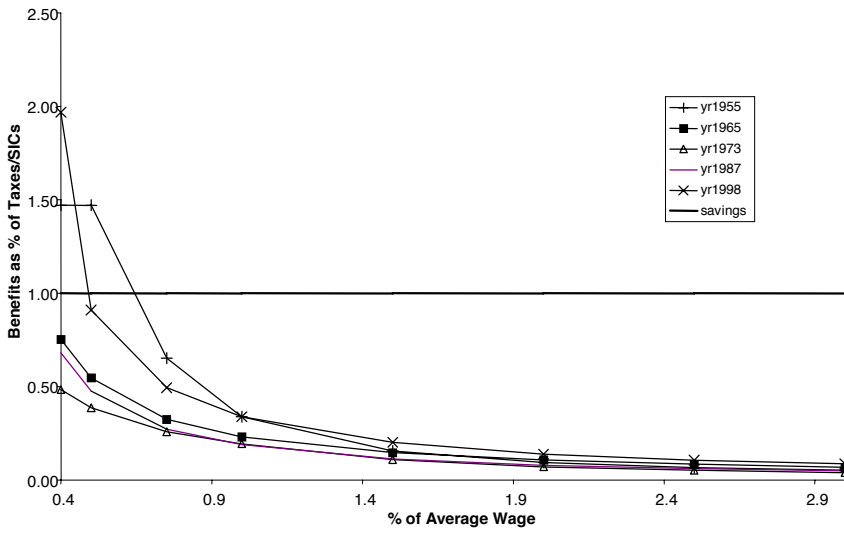
Figure 8 Irish Tax-Benefit System 1955-1998 (Married Couple, 2 Children)



Source: Author's calculations

Note: APW denotes Average Wage of a Production Worker

Figure 9 Lifetime Return from Tax-Benefit System



Source: Author's calculations

DISCUSSION

Dr. Pádraig Carmody: I would like to propose a vote of thanks to Dr. O'Donoghue. This is a very empirically rich paper, which does a superb job of describing and showing the impacts of the tax-benefits system. Among its contributions, it qualifies what are often taken to be truisms about the system. It is well known that the Irish tax base is narrow: there are no local property taxes, for example. However, Dr. O'Donoghue notes that it is also wider in some ways, as social insurance contributions are not deductible from the tax base.

The paper also makes other contributions: showing, for example, how the economic failure of the 1950s and associated high emigration facilitated reduced social expenditure on pensions in the 1990s and thereby contributed to the economic boom. There are some issues it might have been useful to address, although given space constraints this might not have been possible.

In terms of thinking about the social forces and discourses which have driven changes to the tax-benefit system it would also be interesting to know what role social partnership has played. The paper brings out nicely the differences and similarities between the Irish and the UK system, from which it evolved. It might also have been interesting to have a European comparison of social expenditure, particularly given the increasing importance of the EU in guiding social policy.¹ Social rights as a concept are something which have been more prominent in continental Europe. What actors have proposed and propagated them in an Irish context, and how effective have they been?

There is also a debate about how rights should be achieved: directly or indirectly. Some governments are leery of justiciable rights which could lead to open-ended budgetary commitments, undermine the private sector economy, compromise employment and thereby the right to a job. This raises the question of what types of policy actions or international coordination are necessary in order to actualise rights and make them effective?

The paper talks about the movement from regressive indirect taxation to progressive direct taxation in Ireland. It would be interesting to know why this happened. Was this something which resulted from industrialisation and the greater importance of waged work in the economy?

This raises another point about the redistributive nature of the system. Dr. O'Donoghue notes that the value of a single person's tax allowance fell from 60 per cent of the average wage in 1955 to 20-30 per cent in the 1990s, and that given the progressive nature of the system that this increased its redistributive impact. However a question can be raised about the nature of the redistribution. The functional distribution of income after tax, between wages and profits, diverged further during the boom years of the 1990s. The tax-welfare system is strongly redistributive, but as taxes on capital were reduced was it strongly progressive, or

were the transfers largely between those in the labour force and those on social welfare? In terms of the allocation of resources in recent years, the upper deciles received most of the benefits of tax reductions making the system less progressive.

The Irish tax-welfare system has undergone dramatic reforms in the years since 1998 including tax cuts, individualisation and increases in child benefit. There is also some increased complexity particularly in the area of welfare to work. Given the continuing complexity of the system and Dr. O'Donoghue's call for reform, would a basic income, as outlined in the recent green paper, be a feasible alternative?²

Endnotes

1. V. Timonen, "Irish Social Expenditure in Comparative International Context" (forthcoming Dublin: Combat Poverty Agency, 2003).
2. Department of the Taoiseach, Basic Income – A Green Paper (Dublin, 2002 available at <http://www.taoiseach.gov.ie/viewitem.asp?id=1660&lang=ENG>).