Roadmap to Greater Inequality: TASC's Response to Budget 2012

Overview

- This is the fifth austerity Budget. Although TASC welcomes the commitment to budgetary reform, as well as certain individual measures detailed below, this Budget marks a continuation of the previous administrations' failed budgetary strategy.
- This narrow focus on austerity has failed. This is entirely consistent with historical experience across the globe. The current austerity strategy is incompatible with growth and job creation. No serious analysis is provided within the budgetary documents on the econometric evidence relating to the impact of particular fiscal changes on economic growth and employment, nor an impact statement for the changes on household income by decile.
- TASC recognises the need to consolidate the public finances. However debt and deficit reduction are just one side of the equation. Without a viable growth strategy the economy will fail to recover in the short-to-medium-term.
- It is apparent from the Government's medium term fiscal strategy that the goal is to exit the deficit crisis as a low tax economy with a tax take as a proportion of GDP below 35 per cent. This will lead to inferior public services and has long-term implications for the type of economy and society Ireland will become.
- As the latest EU-SILC data makes clear, the new Government's Budget comes in the context of growing levels of poverty and inequality. Despite this, the Government's first Budget will disproportionately affect the poorest income groups in society.
- Compared to the European Union as a whole, Ireland's tax base was already heavily skewed towards consumption taxes prior to Budget 2012. Consumption taxes are the most regressive of the major tax types. Nevertheless, by far the most significant tax change in the Budget was an increase in the standard rate of VAT. The impact of this tax falls hardest on low income groups. On the other hand, the Budget largely protects high earners.
- The wrong choice was also made when it came to property tax. Rather than introducing a progressive, equality-proofed property tax as recommended by TASC, the decision has

been made to introduce a flat rate charge which does not take into account ability to pay.

- Also of concern is the emphasis on new measures to stimulate the housing market. New reliefs and incentives should only be introduced when there is clear evidence of market failure. We should by now have learned the dangers of trying to artificially inflate asset prices. Property-based tax reliefs fuelled the boom and bust in the Irish economy and distorted investment and consumption decisions with disastrous consequences. Rather than trying to stimulate non-productive activity, the Government should seek to engage in a programme of strategic investment.
- The Government's first Budget will exacerbate the jobs crisis and offer little to the long term unemployed. For example the severe cuts to the capital budget will reduce employment by between 7,500 and 9,000. The cuts to the capital budget will also have medium-term impacts on the economy's productive capacity. Meanwhile the VAT increase and cuts to public spending will further depress domestic demand.
- Much like the tax changes the cumulative impact of the cuts will disproportionately impact on low earners. In particular, this is a harsh Budget for children and women. For example the lowest income household grouping in society is the single parent with children group. This group was targeted with cuts to the one parent family payment, cuts to child benefit for the third and subsequent children and cuts to the back to school clothing and footwear allowance. If the parent is a part time worker then they will also be impacted by the reduction in the base for the jobseeker's payment entitlement from a six-day to a five-day week, partially offsetting the benefit derived from changes to the USC. Meanwhile a single childless high earning individual will barely be impacted at all by the budgetary cuts.
- The cuts to a range of employment support schemes and back to education allowances and supports are a false economy in the long-term. At a time of high unemployment the Government should be prioritising the retraining and up-skilling of the unemployed segment of the labour force. The cuts to capitation grants for adult education courses and cuts to allowances for participation in Youthreach are further examples of short-sighted thinking.
- This Budget is a continuation of the failed policies of the past. The fiscal adjustment must be counter-balanced with an investment strategy aimed at embedding job creation

and growth in the economy. We cannot create the conditions for recovery in the absence of a twin-track approach to dealing with the crisis reconciling deficit reduction with growth.

- In the wider European context, the ongoing crisis in the Euro zone makes clear that the currency union contains fundamental design flaws. The absence of a countercyclical fiscal mechanism at the European level is impeding Ireland's chance of recovery and reform of the Euro zone must contain provision for such a mechanism.
- Like previous Budgets, the package announced this week is likely to continue the vicious cycle of shrinking demand, falling employment and growing debt unsustainability. Overall, Budget 2012 is a package of missed opportunities.

Analysis of the Tax Changes

1. TASC welcomes the commitment to budgetary reform, as well as certain tax changes announced in the Budget. In particular the decision to increase the minimum threshold for the payment of the Universal Social Charge will help low earners, but this may be offset for part-time workers by the reduction in the base for jobseekers' payment entitlements. Labour taxes on low-income workers are particularly damaging because not only do they interfere with productive activity but they also have a damaging effect on demand as these workers have a high marginal propensity to consume.

2. The package of reforms for Capital Acquisitions Tax and Capital Gains Tax, when considered in their totality, must be seen as positive but insufficient given the exceedingly generous treatment of capital income in Ireland. Ireland's implicit rate of tax on capital was just 52 per cent of the average rate prevailing in the European Union in 2009[1].

3. Despite these positive changes the Government's revenue-raising decisions are largely regressive in nature. This is principally because the bulk of the expected yield from the new tax measures will come from increases in the standard rate of VAT. Increases in consumption taxes such as VAT tend to impact disproportionately on poorer households. Evidence presented earlier this year by ESRI researchers bears this out[2]. Leahy et al find the groups hardest hit from an increase in the standard rate of VAT to 23 per cent will be households in the poorest income decile, households in rural areas, six person households and households containing a single adult with children. This is particularly disturbing given TASC's own research which has found low income households in general, and lone parents in particular, were the main losers in Budget 2011. The regressive nature of the tax changes must also be seen in the context of growing inequality[3].

4. It is also worrying that the Government's estimated yield of €670 million from the VAT increase does not appear to have considered behavioural changes. This raises the question of whether any of the Government's estimates have been adjusted for behavioural changes. There should be greater transparency about how the Government

[1] Eurostat (2011) Tax Trends in Europe
[2] Leahy et al (2011) The Distributional Effects of Value Added Tax in Ireland, Economic and Social Review, Summer, 42(2), pp 213-235.
[3] CSO (2011) EU-SILC

arrives at its budgetary estimates. This should include fully expressed models and assumptions.

5. The academic literature consistently finds taxing property to be the least damaging form of taxation when it comes to economic growth and employment. If properly designed, such taxes are also some of the least regressive forms of taxation. However the flat rate residential property tax announced by the Government is poorly designed. It will impose the same burden on those in mortgage distress, and those on low incomes, as it will on the very wealthiest in society. TASC has called for the implementation of a property tax based either on the value of the property or the value of the site. To prevent hardship property taxes should be based on a deferral system for those on low incomes.

6. While TASC welcomes the increase in carbon tax, it is regrettable the Government reduced the fuel allowance season rather than off-setting the carbon tax increase with measures to reduce fuel poverty. Once the application of this increase to home heating fuel come into force, it will have a severe impact on many social welfare recipients in view of the fact that, according to the Institute for Public Health, around 70 per cent of additional winter mortality in Ireland for cardiovascular and respiratory diseases occurs in the poorest socio-economic groups[4].

Analysis of Current Spending

7. While the maintenance of most primary Social Welfare rates is welcome, it should be borne in mind that this represents a further real cut in income when inflation is factored in and when additional charges and withdrawal of services are considered. The impact on low-income families, young people, women and the unemployed is likely to be very significant.

8. Many of the cuts impact on a number of levels – withdrawal of specific payments, extra charges and reductions in budget lines for organisations representing particular groups. In the case of the last, the decision to reduce the budget of the National Womens' Council by 35 per cent will save the Exchequer €187,000. This will have virtually no impact on the deficit, but a disproportionate impact will be felt by women's groups around the country. These changes are cumulative in many cases and must be

[4] Institute of Public Health 2011, http://www.publichealth.ie/healthinequalities/Fuelpovertyandhow

considered in the context of previous Budgets. It is deeply regrettable that the Government appears to have failed to equality-proof its Budget 2012 measures.

9. It has been announced there will be cuts to the higher rates of child benefit for the third and subsequent children over two years. According to SILC 2009, the at-risk-of-poverty rate for households containing two adults with three or more dependent children was 18 per cent. The reductions to child benefit of 11.4 per cent for the third child and 9.6 per cent on the fourth child are likely to increase the risk and severity of poverty for larger families.

10. Lone parent families appear to be particularly worse off with new restrictions to entitlement for One Parent Family Payments. This reform has been presented as “bringing Ireland’s support for lone parents more in line with that provided internationally”. However, if this is to be real reform and not just about cutting supports to lone parents we need to see other international best practice applied here in Ireland – such as reducing the cost of childcare, which is amongst the highest in the OECD, by providing state-subsidised high-quality affordable early year childcare and flexible afterschool care.

11. Activation policy also needs to be reformed to facilitate participation in education and training, and access to work experience for the purpose of up-skilling and retraining. The Budget also included an announcement of €20 million for a Labour Market Activation Fund. This works out at approximately €65 extra for each person who is unemployed. At the same time there are to be cuts to the qualified child increases, changes for new Community Employment applicants and cuts to back to education allowance, student supports and access initiatives under the Departments of Social Protection and Education. These measures will make it more difficult for lone parents, in particular, to access and participate in education and training initiatives.

12. Cuts to the capitation grants for schools will impact on subject choices and the general resourcing of schools. Schools in a position to subsidise reductions in their capitation grants with ‘voluntary contributions’ from parents will undoubtedly fare better. Cuts to school transport will add to the cost of sending children to school. This measure will have a disproportionate impact on families in rural areas where there is unlikely to be an adequate public transport system in place. Other regressive measures include cuts to capitation grants across a range of further and adult education courses, and cuts to

allowances for participation in Youthreach, Community Training Centres and FÁS courses. These measures are particularly unfortunate as they are likely to act as a barrier for many students wishing to participate in these types of training initiatives. The profile of participants in these courses tends to include many young people for whom the mainstream education system is not an option. Finally, cuts in student supports and access initiatives, along with increases to the student registration fee, will make it more difficult for low and middle-income families to support their children in third level education.

13. These are false economies. We should be prioritising education and retraining programmes to improve the overall level of human capital in the workforce. We need programmes to transform the skill sets of the unemployed and other workers to match the needs of the economy. The simple fact is the skill base of the unemployed segment of Ireland's labour force is likely to be far out of step with the future needs of the economy. This is particularly the case for the 100,000+ former construction workers who have lost their jobs. For many of these workers there is little prospect of future employment in Ireland without opportunities to upgrade their knowledge and skills.

14. The impact of this Budget on social welfare recipients and low earners will have severe consequences not only for the households concerned, but also for the economy as a whole. At a time when consumer demand remains weak and the ESRI predicts GNP to contract by 1.3 per cent next year, these measures will take more money out of the pockets of those who spend most of their incomes in the domestic economy and will simply exacerbate the crisis in demand.

Analysis of Capital Spending

15. The Government's decision to disproportionately cut capital spending is ill-judged. Ireland will have the lowest rate of gross fixed capital formation in the EU next year according to Eurostat[5]. Government policy needs to compensate for the low levels of private and public investment in Ireland's productive capacity. In concrete terms, not enough money is being put into new factories, machinery, computers, training, research

[5] Eurostat (2011), pp 68-69: http://ec.europa.eu/economy_finance/publications/european_economy/2011/pdf/2011-05-13-stat-annex_en.pdf

and development, and all of the other similar productive investments that are required to expand the knowledge base and productive and technical capacity of the economy.

16. The Economic and Fiscal Outlook states government investment will fall from 3.7 per cent of GDP in 2010 to just 1.4 per cent of GDP in 2015[6]. The Government's Comprehensive Expenditure Report identifies a reduction of over 15 per cent in capital spending. This is far in excess of the percentage increase in revenue raising measures or decrease in current spending, and will have negative implications for the economy's future productive capacity.

17. International evidence suggests the Irish Government's decision to disproportionately cut capital spending is the worst decision they could have taken in terms of influencing future economic growth and employment. The UK's Office of Budgetary Responsibility[7] (OBR) examined the 'impact multipliers' of changes in different taxes and types of spending on growth. The OBR found capital investment to have the greatest positive impact on employment and growth. The OBR estimates that changes in personal tax and social insurance are the least effective measures at stimulating growth and employment while capital spending measures are the most effective. Of course capital spending has the additional advantage of adding to the economy's productive capacity over the longer term. Research by the International Monetary fund (IMF) also shows capital spending to be the most effective measure for increasing growth and employment[8]. It is disappointing that the Government has chosen to ignore the best international evidence when setting their fiscal policy priorities.

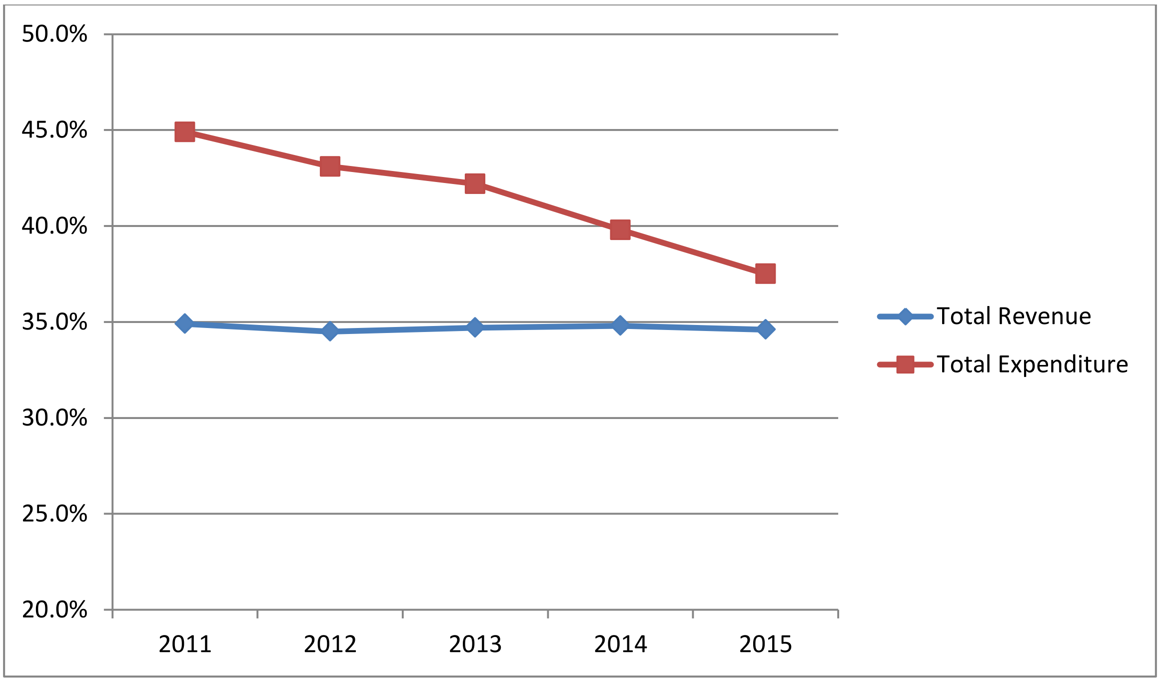
Medium term Strategy

18. The table on page D.19 of the Economic and Fiscal Outlook (EFO)[9], released as part of Minister Noonan's budget papers, gives a clear indication of the Government's planned end-goal with respect to revenue and public spending levels. This is illustrated in the following chart.

[6] Department of Finance (2011) Economic and Fiscal Outlook, Table 11, December
[7] Office of Budgetary Responsibility (2011): http://www.hm-treasury.gov.uk/gov/d/junebudget_annexc.pdf
[8] International Monetary Fund (2009): http://www.imf.org/external/pubs/ft/spn/2009/spn0903.pdf The efficacy of the different policy measures can be found in the Appendices.
[9] http://budget.gov.ie/Budgets/2012/Documents/Economic%20and%20Fiscal%20Outlook.pdf

19. Although Budget 2012 introduced €1.0 billion in new tax measures, and the Economic and Fiscal Outlook (page D.18) envisages an increase in tax from nearly €36 billion in 2012 to over €43 billion in 2015, the chart shows taxation as a percentage of GDP will remain fairly constant, at around 35 per cent of GDP.

Chart: Revenue and Public Spending Levels 2011-2015 (% GDP)



20. In contrast, measures to cut public spending are anticipated to reduce the overall level of public expenditure from €49.5 billion net in 2012 (44.9 per cent GDP) to €46.4 billion net (37.5 per cent GDP) by 2015. This indicates that the Government's strong preference is to return Ireland to its pre-crisis trend of low taxation and low spending in comparison to the EU average levels. In the end, the Government has chosen overwhelmingly to focus on cutting expenditure.

Conclusion

21. This Budget lacks any credible commitments to either fairness or job creation. The cumulative impact will be to lower domestic demand further, exacerbate inequality and increase unemployment.

22. The Economic and Fiscal Forecast (page D.9 of the EFO) assumes that unemployment will fall from 14.3 per cent in 2011 to 11.6 per cent in 2015. In this context, they anticipate a fall in social payments from 17.3 per cent GDP in 2011 to 13.6 per cent of GDP in 2015 – this is a highly optimistic assumption given the debt overhang, lack of credit, and continuing austerity both within Ireland and by our major trade partners. If jobs fail to materialise, this will seriously disrupt the Government's planned trajectory for the reduction of spending, unless further severe cuts are made to social payments. This has implications for Ireland's debt dynamics.

23. It is clear the current pro cyclical fiscal stance is embedding the depression. Long-term unemployment is now at crisis levels and there is a huge risk that high levels of cyclical unemployment will turn into high levels of structural unemployment with disastrous long-term social impacts. Our debt burden (public and private) is consistent with years of future stagnation. If we cannot reduce the debt burden or spark nominal GDP growth then the next few years will be very grim. This Budget is a missed opportunity.

24. In conclusion, there is little in this Budget to suggest that the Government has a coherent and considered strategy to create new employment or restore economic activity. Finally, there appears to be no sense of equality that would put the interests of low income groups and other vulnerable people before those of high-income and high-wealth individuals.