

Austerity, Distribution and Work Incentives: Microsimulation Evidence for Ireland

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Background

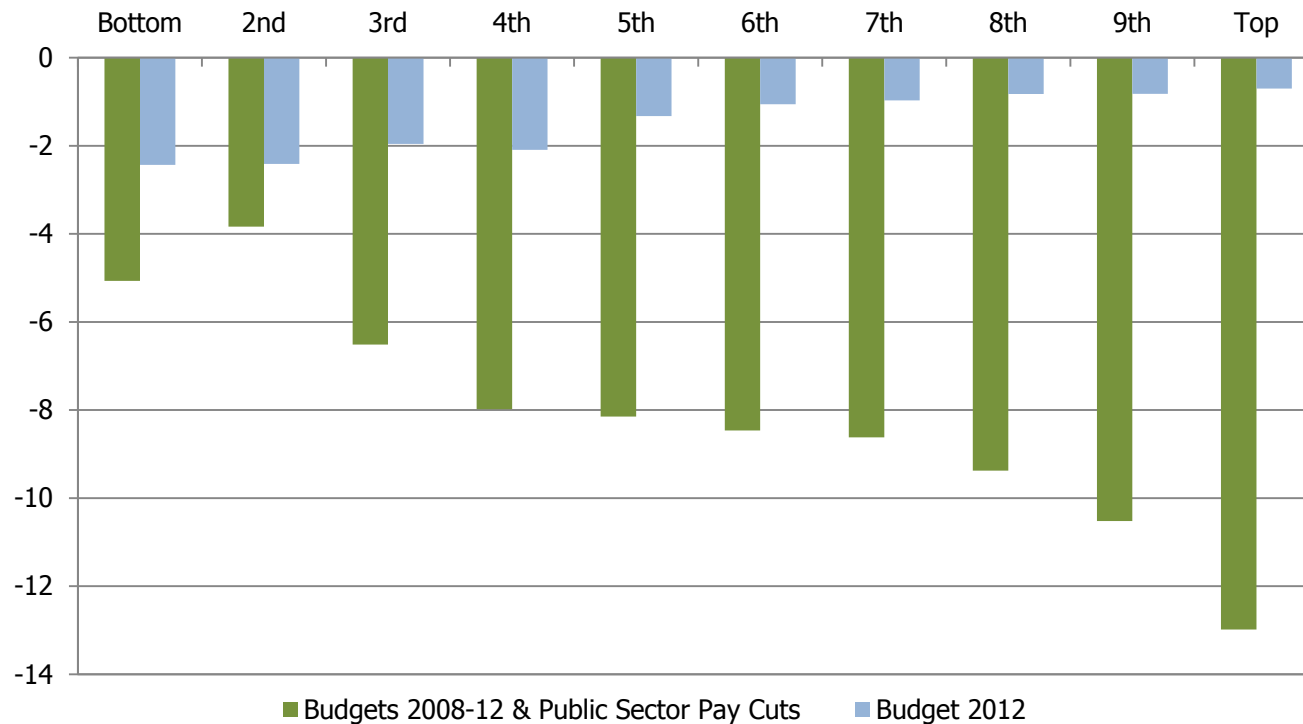
- Ireland 2007-2012
 - One of the deepest recessions on record
 - Bursting of property bubble
 - Banking crisis
 - Fiscal crisis
 - International downturn
- Strong fiscal austerity measures adopted
 - Began in 2008
 - Continued under troika supervision 2009-date

Distributional impacts of recession and of policy response



- Distributional impact of recessionary forces
 - Increased unemployment, differential declines by sector
- Distributional impact of government actions
 - a) Tax, social security/welfare policies
 - b) Public sector pay cuts
 - c) Cutbacks in services
 - d) Cutbacks in investment expenditure

Impact of Budgetary Policy (2012 and 2009-2012) by Income Decile



Source: Callan et al. (2012)

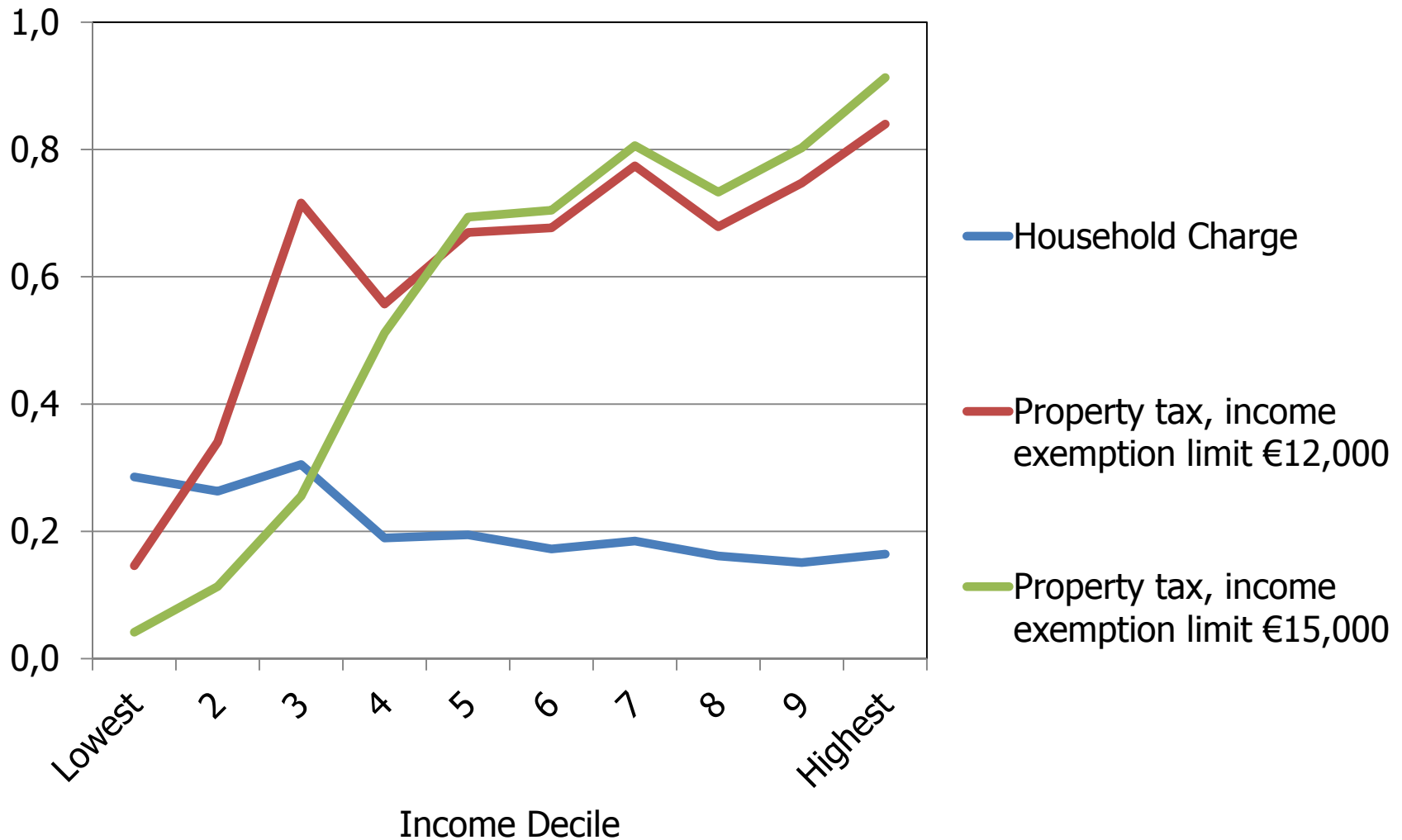
Time path of policy changes

- Budget 2009 (October 2008, April 2009)
 - Major focus on tax measures
 - Effective public sector pay cut
 - Welfare payment rates were increased by 3%
- Budgets 2010, 2011
 - Further tax increases
 - Explicit public sector pay cuts
 - Welfare cuts (working age, children)
- Budget 2012:
 - more limited tax measures, specific cuts in welfare
- Pension payments not cut

Exploring options for a tax on residential property



Property tax as % of disposable income

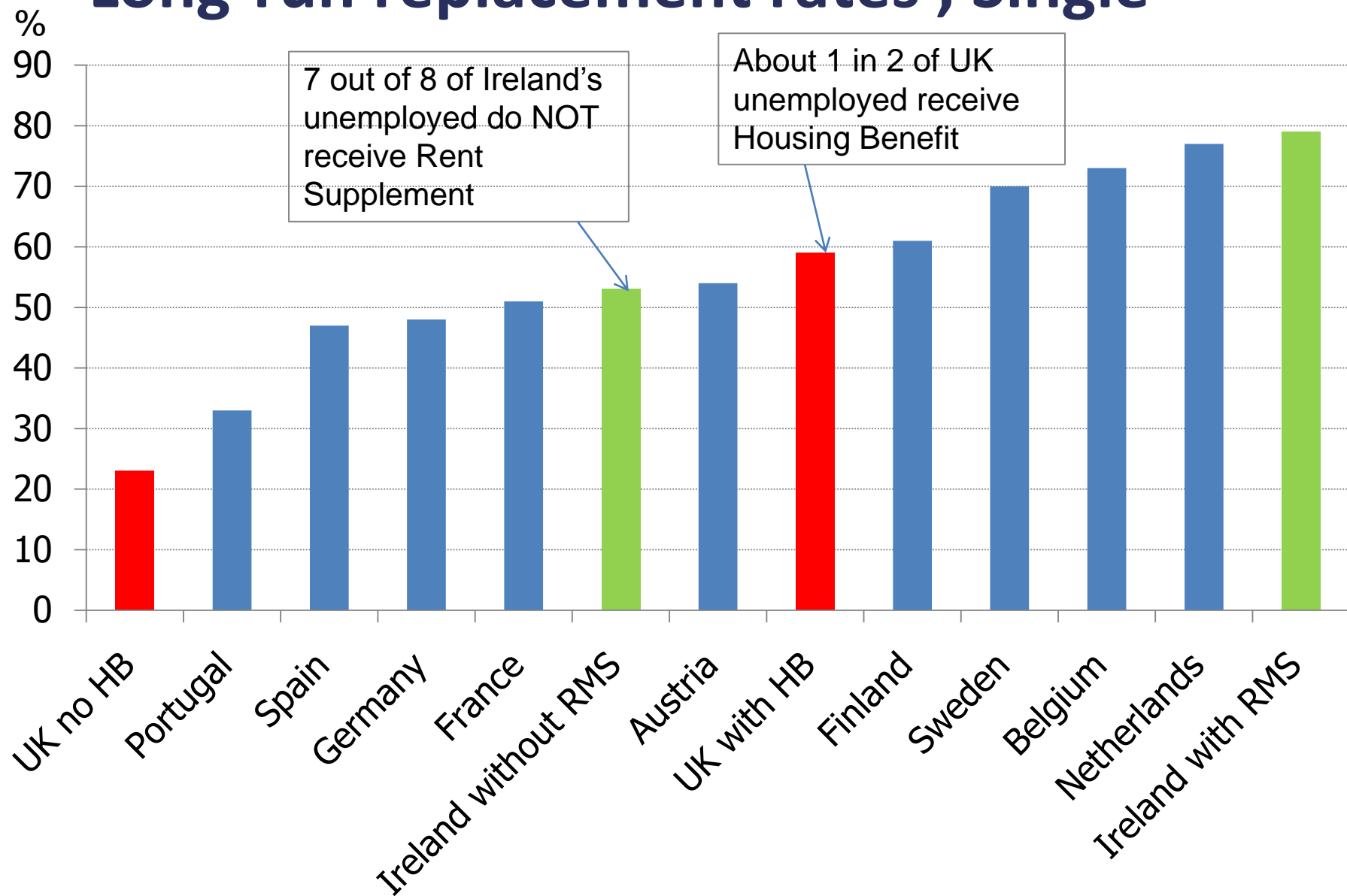


Work incentives and benefit generosity



- “Replacement rates” (RRs): ratio between out-of-work income and in-work income
- OECD statistics on replacement rates
 - based on a set of example households
 - commonly used as indicators of benefit generosity across countries
- These statistics may not give a representative picture
- Example: Ireland and UK, where microsimulation results show that conclusions drawn from OECD statistics can be misleading

Long-run replacement rates , Single



Measuring Replacement Rates using Microsimulation



- Replacement rates are not directly observable – need to know
 - “what if” an unemployed person became employed: predict their gross wage and then let taxes/welfare adjust to their new income and employment status
- Microsimulation models make these estimates for large scale, nationally representative surveys
- Thus provide a nationally representative picture, rather than one based on selected examples

Replacement rates: Ireland and the UK, All (workers & non-workers)



	UK	Ireland
	%	%
Above 70%	26	24
Above 80%	14	13
Above 90%	4	7
Above 100%	<1	4

Microsimulation: Better diagnosis, and help in finding a cure



- Microsimulation analyses show that
 - 6 out of 10 of those with replacement rates above 100% are receiving Rent Supplement
 - 7 out of 10 of those receiving Rent Supplement have high (over 70%) replacement rates
- Microsimulation analysis can be used to explore alternative designs for a Housing Assistance Payment
 - neutral with respect to employment status

Conclusions

- Microsimulation is essential to get an accurate overall picture of distributional impacts and work incentive implications
- Comparisons based on examples can be misleading
 - Even when carefully conducted – adding more examples does not build up to a representative picture
- Microsimulation can be used
 - To monitor policy impacts
 - To explore options in advance of choice and implementation

Composition of Irish unemployment

% of unemployed

