



# Briefing Paper



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# Making Work Pay

## Introduction

One of the main priorities during Ireland's presidency of the EU is to 'Make Work Pay' as it is a key priority for the Member States. 'Making Work Pay' means that the take up of employment should guarantee a real increase in household income. The INOU feels that this term 'making work pay' is too pejorative and shifts the blame of being unemployed onto the individuals rather than addressing the structural causes of unemployment. Unemployed people do not choose to be out of work and their re-entry into the labour market can be even more difficult with the presence of financial and non-financial disincentives that exist. These disincentives can result in unemployed people being financially worse off upon the take up of employment, thereby preventing people from entering, remaining and progressing in the labour market. This paper will identify the main unemployment traps preventing people from taking up employment. Such traps affect not only unemployed people but also those distanced from the labour market as well as those in low paid employment. The elimination of these traps will involve policy changes in many departmental areas but especially in the interaction between the welfare and tax systems. Emphasis on 'making work pay' and attracting more people into the labour market is vital if the following Government commitments and targets are to be realised.

These are:

- To build 'the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.' (Lisbon Goal set at the European Council, 2000).
- To attain the EU employment targets set at Lisbon of 70% overall employment rate, 60% female employment rate and 50% employment rate amongst older workers (aged 54-64), (Lisbon Goal set at the European Council, 2000).
- To 'eliminate long-term unemployment as soon as circumstances permit but in any event not later than 2007'. (National Anti-Poverty Strategy, 2002)

## Current Government Policy

Various Government and European policies and recommendations stress that employment is the best route out of poverty and therefore to facilitate access to employment there is a need to adjust the balance between taxes and benefits. Such policies include:

The NAPSincl objective to 'eliminate any remaining gaps or disincentives to employment / training in the application of the secondary benefits systems so that, at a minimum, nobody is materially worse off as a result of taking up employment, training or educational opportunities'. (NAPSincl 2003)

'Member States must seek to end unemployment, inactivity and low pay traps by adjusting the balance between taxes and benefits, focusing on the low paid'. (European Employment Taskforce, 2003).

'The tax and welfare system should facilitate progression, choice and risk taking while guaranteeing income security'. (NESE, 2000)

However, despite these recommendations and objectives little effort has been made to eliminate any of the disincentives that exist. In addition, due to recent changes in the social welfare code other disincentives now exist.

## FINANCIAL DISINCENTIVES TO TAKE UP EMPLOYMENT

### Low Threshold of Secondary Benefits

The threshold for the retention of secondary benefits such as rent supplement and Back to School Clothing and Footwear allowance has remained unchanged at €317.43 (old £250) since 1994. It has not kept pace with either inflation or wages and can result in a substantial loss of income if the wages offered upon the take up of employment is above this threshold.

Also the recent changes to the eligibility for rent supplement have exacerbated the situation, because under the new rules once one of a couple works full-time

(30hours) regardless of wages both are ineligible for rent supplement. The examples below show the effects of being ineligible for rent supplement on a sample of low-income households.

### **Couple with no children**

A couple who have no children, were in receipt of Unemployment Assistance and a Qualified Adult payment as well as rent supplement<sup>1</sup>. Their weekly household income was €224.20, which reduced to €211.20 following payment of their rent contribution of €13. Overall, the household income genuinely increases upon the take up of employment. However, their income becomes unsustainable once the QAA works more than 30 hours, dropping to €88.65 for when she/he works 3 days or less. This clearly creates an unemployment trap. This household income is even below the lowest social welfare payment level for a single person - a threshold that the Government vowed nobody would fall below.

### **A family - husband, wife and four children**

A person is offered a full time job (39 hours per week) paying €380 per week. The family is subsequently ineligible for rent supplement and this results in the household income being less than €150 per week which includes a top up from the Family Income Supplement. Needless to say this amount is unsustainable for a family of this size. Interestingly, if the person remains unemployed the household income would be €291 and they would keep their rent supplement.

### **Loss of medical card**

In recognition that the loss of one's medical card poses a serious barrier to the take up of employment amongst unemployed people and others, individuals can now retain their medical card for three years after taking up employment. However, for some the fear of losing their medical card is too great, as they fear they will be unable to meet the medical needs of their family. The INOU has continually called for the extension of the medical card scheme to all children under 18 years thereby reassuring parents that the take up of employment would not deny any future medical treatment for their families. The possibility of tapering some of the services provided under the medical card scheme such as number of GP/dentist visits could also be explored.

### **Removal of National Minimum Wage Earners Out of Tax Net**

The Programme for Government restates the commitment to remove minimum wage earners out of the tax net and to move 80% of taxpayers onto the standard rate of tax. However in relation to the former, the national minimum wage (NMW) increased to €7 per hour in February 2004. In honouring the Government commitment, successive budgets have only increased the employee PAYE tax credit in order to keep 90% of the income of those on the NMW out of the tax net.

Therefore all minimum wage earners are still paying some portion of income tax. The scale of employees on the NMW was highlighted in a recent study of employers by the ESRI. It showed that 25,000 private sector employees were paid the NMW and 32,000 were paid below this level in 2002. The majority of those 32,000 are those employees not covered by the NMW Act, i.e. those aged less than 18 years, apprentices, those who work in sheltered employment etc. The study found that the majority of these employees paid at or below the NMW are based in the hotel/restaurant sector. Given that the numbers affected by this outstanding commitment is less than 60,000 employees, why is this commitment still outstanding? With NMW earners still paying a portion of tax it is understandable yet unacceptable that 18.8% of all households in poverty are headed by an employee (ESRI 2003).

### **Some Employees Not Covered by PRSI**

For the majority of employees the take up of employment will ensure that they contribute to the Social Insurance Fund through their PRSI contributions. This will ensure their eligibility for unemployment benefit, maternity benefit, old age contributory pension etc if and when required. However, under the current system some employees are not covered for such payments. These include:

- A spouse who is in the employment of his/her spouse's business
- A relative who is working in a family business.

These employees cannot seek compensation or assistance from the Social Insurance Fund despite having been in employment.

The European Employment Taskforce 2003 emphasises the need for labour markets to be more flexible while providing workers with appropriate levels of security. This combination is in the interests of employers as well as employees. If the tax and welfare systems are to increase the balance between flexibility and security it must be inclusive of all types of workers.

### **Genuinely Seeking Work**

The number of employees taking up part time employment has continuously increased in recent times. An increase of 14,500 part-time employees between 2001 and 2003 was recorded, of which 78% are women (CSO, QNHS 2003). However, should any of these employees become redundant and unemployed they would not receive an unemployment payment because under Ireland's male breadwinner model of social welfare only those in search of and available for full time work receive an unemployment payment. There is currently no entitlement to a part time unemployment payment for unemployed people whom due to their caring responsibilities or otherwise are only seeking part time work. The social welfare system is not flexible enough

<sup>1</sup> Based on a weekly rent of €178. (Eastern Regional Health Authority 2004 maximum rent level for a couple with no children.)

yet to cater for atypical workers. As mentioned above, a more inclusive model of social welfare is needed.

### Family Income Supplement (FIS)

FIS was introduced to increase the reward from work by providing low paid households with additional income. However, to gain real value from FIS it needs to keep pace with increases in average earnings. FIS is currently calculated at 60% of the difference between net weekly income and the income limit for the family size. The INOU believes that this calculation should be re-examined to ensure a discernible reward from work is maintained. FIS is only available to low income households with children. What additional support is there for childless couples as mentioned above whose income can become unsustainable upon the take up of full time employment?

### Possible Solutions

While there are a number of actions that need to be taken (see below), the INOU recognises that for reasons of health, age, parental duties etc access to and participation in the labour market may not be possible for all and such persons should not experience heightened poverty and social exclusion as a result.

According to the Joint Employment Report any reforms in the tax-benefit systems need to be linked to minimum wage setting to ensure adequate level of earnings to make the take up of work more attractive to unemployed people and those currently inactive. The current minimum wage of €7 per hour is approximately 50% GAIE and the INOU believes that this benchmark should continue thereby ensuring that the NMW will keep pace with changes in wages.

The European Employment Taskforce suggests a number of practical measures that can be taken to address some of the financial disincentives, these include:

- Supplement low wages, where necessary, through the use of in-work benefits, as an incentive for workers to accept low-paid jobs, while maintaining wages at a level reflecting productivity.
- Ensure that income-dependent benefits (such as family or housing allowances) fulfil their role of alleviating poverty without constituting a disincentive to take up a job.
- Make part-time work financially more attractive for people who wish to balance family with working life, and older workers wishing to combine gradual retirement with part-time work.

Interestingly the Irish Back to Work allowance scheme is praised by the European Employment Taskforce for being progressive and effective in encouraging unemployed people back into the labour market. However, the qualifying period for this allowance, which allows people to keep their social welfare payments on a tapered basis, was changed to 5 years unemployed.

Subsequently the number of unemployed people benefiting from this allowance has reduced drastically. The INOU has continuously lobbied for this qualifying period to be returned to 15 months as it has proved to be an effective tool in assisting unemployed people to take up low-paid employment.

The INOU would also welcome the possible tapering of other payments such as rent allowance etc over a 3 or 4 year period. A financial cushion in the absence of any in-work benefits is required in order to ensure that the take up of employment will result in a genuine increase in income.

INOU recommended solutions to eliminating unemployment traps:

- Increase threshold for retention of secondary benefits
- Extend coverage of medical card
- Remove all NMW earners out of the tax net
- Include all employees in the PRSI system
- Introduce a part-time unemployment payment
- Re-examine calculation of FIS and extend coverage to childless couples
- Return eligibility for Back to Work Enterprise Allowance and Back to Work Allowance to 15 and 12 months respectively
- Examine possibility of tapering other social welfare payments such as rent allowance to provide financial cushion to those returning to low paid work.
- Increase provision of quality and affordable childcare

### Non-wage costs that create disincentive to take up employment

Now turning to some of the non-financial disincentives that exist preventing the take up of employment. These are broader societal barriers that prevent people from entering, remaining and progressing in the labour market. By addressing these barriers the overall employment rates would rise, particularly for women.

### Lack of Childcare and Eldercare

The lack of provision, quality and affordable care for both children and other dependants has a direct impact on female participation levels and in their take up of full-time work over part-time work. Also the availability of such care services will also create new job opportunities often to the benefit of women. The fixed cost nature of childcare/eldercare means that it is parents on low incomes who are most in need of support. Many parents need to spend time on training and/or education in order to get a job and incur care costs during that

time. Low paid parents would not benefit from tax relief, as they do not earn enough to claim it. Childcare/eldercare provision as previously mentioned in various fora should be available in a variety of formats to reflect the diversity of work/education patterns. Such a care system would include company/college crèches, community based facilities etc thereby facilitating carers working within and outside the 9-5 working day, those participating in adult education or mainstream education and training. By EU standards, Ireland's lack of provision and affordable childcare facilities was noted as an area of particular concern affecting female employment rates.

### Work - Life Balance

In addition to the above, both the Government and some employers are not doing enough to facilitate the achievement of a work/ life balance. Strict working patterns combined with fewer opportunities for those in low-paid employment can prevent employees from undertaking parental leave, a career break, working flexi-time, educational courses etc. The availability of options to enhance work/life balance should be accessible to all workers regardless of position.

### Quality of Work

If Ireland is to play its part in the EU goal of being 'the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion', investment in human capital is vital. Such investment is required across all sectors and in all jobs. Employers should build employees' skills throughout their career thereby increasing productivity and competitiveness. To encourage the take up of low-paid employment, access and availability to training and progression within the company should be visible for all employees. In response to the revelation that those in low-paid employment are least likely to be offered or undertake training, FÁS is shifting its training emphasis to those in employment. The objective is to increase the employability chances of those in low-paid employment to enable them to progress within work and to protect them from unemployment should they become redundant. The INOU welcomes this initiative as long as training/employment services to the unemployed and those distanced from the labour market continues thereby increasing their chances to take up employment and hopefully progressing upward within it.

### Transports Costs

For unemployed people and those distanced from the labour market the additional costs of participating in the labour market can become a disincentive from taking up low-paid employment. Such extra costs include, the recent increases in public transport fares, high insurance premiums on vehicles and poor public transport facilities in rural areas. Although the public transport infrastructure is improving, its availability, affordability and accessibility for everyone throughout the country needs to be constantly monitored.

### Disincentive to job creation

In the area of enterprise development, the European Employment Taskforce recommend that some EU member states reduce the administrative and regulatory obstacles to the setting up and managing of businesses and should also improve access to finance for start-ups and small and medium enterprises. In Ireland, the main barrier identified by small businesses preventing their further investment, development or expansion was the escalating insurance costs. (Small Firms Association, 2003) Increases in insurance costs for firms ranged between 52%-70% in 2003. The SFA feel that the pace of Government reform of the personal injury system is not fast enough to have had a necessary impact on reducing premiums.

For individual entrepreneurs, the Back to Work Enterprise Allowance has been useful although its success is now restricted due to changes in the eligibility criteria. It operates on a similar basis to the BTWA however the qualifying period was changed from 12 months to 5 years before reducing to 3 years. The INOU has consistently asked for it to be returned to 12 months as the longer an individual is unemployed the less likely they are to have the resources, motivation and supports to set up a business. This allowance has proved to be effective in creating sole traders and SME's and more unemployed people should be given the opportunity to avail of this allowance and hopefully in the longer term employ others.

### Conclusion

This paper has highlighted some of the financial and non-financial disincentives that prevent unemployed people and those inactive from taking up employment. Such disincentives also can affect the progression of those in low-paid employment. Although the harmonisation of the welfare/tax systems is recommended in many reports and policies, the INOU wishes to see more decisive action being taken to put these recommendations into practice thereby facilitating more entrants into the labour market.

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