

Gender and Income Tax in Ireland: A Tale of Three Systems

Tim Callan

Economic and Social Research Institute

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Address for correspondence:

Tim Callan

ESRI

4 Burlington Road

Dublin 4

email: tim.callan@esri.ie

1. Introduction

There is wide variation across countries in the income tax treatment of couples, as evidenced by reviews such as that of the Congressional Budget Office (1997) and O'Donoghue and Sutherland (1999). Broadly speaking, the different systems can be characterised as lying on a spectrum between joint taxation, where tax liabilities depend on the joint income of the couple, and independent taxation, where each partner's income tax liability is determined independently of the other.¹ These structural differences in tax systems can have a significant impact on the incentives shaping couples' decisions regarding labour market participation. Even when nominally gender-neutral, the net effect of joint taxation systems is typically to depress married women's labour market participation below the rates which would obtain under independent taxation. The tax treatment of couples can also affect both the distribution of income as between households, and the intra-household distribution of resources.

The general trend in the EU has been away from joint taxation and towards greater independence. (O'Donoghue and Sutherland, 1999). Austria, Belgium, Denmark, Finland, Italy, the Netherlands, Spain, Sweden and the UK have moved away from joint systems of taxation of earned income during the past 30 years (OECD, 1993)). Major structural changes of this type are not undertaken lightly. In the UK, for example, there was extensive analysis and discussion of possible reforms. In this context, it makes sense to learn from the actual experiences of other countries. In this paper, I describe and analyse the Irish experience, which involved three different tax treatments of married couples within the past 40 years: two quite distinct forms of joint assessment, and more recently, a move towards greater independence in the tax treatment of husbands and wives.

The paper is structured as follows. The next section sets out how the different tax treatments of couples used across countries have been classified, and how the three systems used in Ireland are located within that framework. Section 3 explores how the timing of the changes in tax system relate to the strong growth in married women's labour market participation over the past 35 years. Section 4 summarises a more formal analysis of the impact of the most recent change in the tax treatment of couples. The impact of this change in tax structure is compared with the effects of tax cuts, within an unchanged structure. Issues

¹ A finer classification is introduced in the next section, allowing for different types of joint taxation.

relating to how the tax changes were perceived and debated are discussed in Section 5, and the main conclusions are drawn together in the final section.

2. Income Tax Treatment of Couples

International classifications of the tax treatment of couples typically use the distinction between joint assessment and independent assessment as the main axis on which tax systems are located.² Within the joint assessment systems O'Donoghue and Sutherland (1999) identify three quite different approaches:

1. *Aggregation* of the incomes of husband and wife, and taxation of the total income using the same rates and bands as apply to single individuals. There may be a married couples allowance or tax credit of some sort, but the net effect of the overall system will be to impose a “marriage penalty” on couples with incomes above some threshold level.³
2. *Income-splitting* also involves aggregating the incomes of husband and wife, but then splits or halves that aggregate income and taxes each individual as if they had a half-share of the total income. Under a progressive system, two cohabitees with the same total income as a married couple will typically pay a higher tax bill if their individual incomes are such that they have different marginal rates of tax. It may be said, therefore, that there is a “marriage premium” associated with this approach.
3. *Family quotient* systems have some similarities with the “income splitting” idea. The total family income is divided not just by 1, for a single person, or 2 for a couple, but by a divisor which depends also on the number of children in the family.⁴

By contrast to all of these approaches, a fully independent system involves separate tax credits or tax free allowances for each individual, and each individual married or single faces the same bands and rate structure. This pure form of independence is not common: many systems will have some elements, such as an allowance or credit transferable between spouses or available to one-earner couples, which represent a compromise on full

² Some systems offer choices regarding assessment which may influence the distribution of tax liabilities as between spouses, but we focus here on the impact of different systems on the *total* tax bill.

³ Correspondingly, there can be gains for lower income couples. The US system is characterised by this coexistence of marriage penalties and marriage premia.

⁴ For example, in the French “quotient familiale” husband and wife each count for 1 unit, and the divisor increases by a half unit for each of the first two children, but by a full unit for each subsequent child.

independence. Nevertheless, over time a number of countries have moved from systems involving “income-splitting” or extensive transferability of allowances between spouses to systems involving greater independence in the tax treatment of husband and wives. O’Donoghue and Sutherland (1999) found that 10 out of 15 EU countries had income tax systems which were based around independent or individual taxation of husbands and wives.

The Irish tax system – like the UK system of the time – initially treated married couples as a unit for income tax purposes, with the wife’s income being *aggregated* along with that of her husband. While there was a “married man’s allowance” tax was assessed on the basis of the same band width as for single persons. Compared to two cohabiting single persons, a married couple received a marriage subsidy if the wife was not earning an independent income, or earned a very low one. But if the wife’s earnings were greater, she, and the couple, faced a substantial tax penalty – a married couple with both partners in employment could face a higher tax bill than an unmarried couple in identical circumstances.

Table 1: *Income tax treatment of couples in Ireland, 1922-2006*

	<i>Period</i>		
	<i>1922-1979</i>	<i>1980-1999</i>	<i>2000-2006</i>
Income tax treatment of couples	Aggregation	Income-splitting	Greater independence

A legal case⁵ was taken against this system during the 1970s, attacking the constitutionality of the tax regime on the grounds that it imposed a “marriage penalty” on two-earner couples. Ireland’s written constitution committed the State “to guard with special care the institution of marriage”. The Supreme Court ruled in 1979 that the implicit “marriage tax” in the income aggregation provisions of the tax code was unconstitutional.

A number of responses to this ruling may have been possible, including a move towards greater independence in the taxation of husbands and wives. The response chosen by the government, and implemented in Budget 1980, was to allow doubled rate bands and doubled allowances to all married couples. Formally, this was equivalent to allowing “*income splitting*” i.e., calculating the couple’s tax liability on the basis of assigning half the income to each partner and taxing them as if they were single. It was also equivalent to full transferability not only of allowances but also of rate bands. Married couples were permitted

⁵ The case (known as the Murphy case) was taken by a married woman who was in paid employment.

to minimise their tax liabilities by assigning allowances and rate bands freely to either partner.

The main reason given for this approach in the 1980 Budget Speech was that “A narrow approach towards effecting the minimum changes to meet the Supreme Court’s decision would lead to unjustifiable discrimination against the one-income family, particularly where a married woman elects to care for the family on a full-time basis at home rather than take up work outside the home.” (Government of Ireland, 1980:18).

Callan and Farrell (1991) commented that if, as would appear from this statement, the policy objective was to subsidise childcare undertaken by married women in the home, the mechanism chosen was a rather inefficient one. The tax subsidy is not conditional on having children, but on being married – implying that “the benefit from this tax break is, in terms of its main stated objective, rather inefficiently targeted”. Furthermore, the mechanism imposed high effective tax rates on married women with and without children, thereby giving rise to a substantial efficiency loss. Callan and Farrell concluded that other methods of providing child income support, notably through child benefit, might involve smaller efficiency losses and better targeting. Fahey (1998) came to a similar conclusion, based on an analysis of Labour Force Survey data, finding that “Many who receive the subvention are not engaged in childcare, and many of those with young children who have a heavy childcare burden do not receive the subvention”.

More recently the Irish tax system has moved towards greater independence in the tax treatment of couples, in what has been termed “individualisation” of the standard rate tax band. Budget 2000 initiated a move towards individualisation of the standard rate tax band. This involved restricting the extent to which tax bands are transferable between spouses. In 1999 the standard rate band was about⁶ €17,800 for an individual, or €35,600 for a couple i.e., a non-earning partner could transfer 100% of his or her tax band (and, indeed, of his/her allowance). In 2000, full transferability of tax allowances remained as before, but there were, in effect, restrictions on the transferability of the standard rate band. The band for a single person was increased from €17,800 to €21,600 per annum; for a married couple with one income the band remained unchanged at €35,600 per annum; but the band for a married couple, both earning, rose to €43,200 (twice the single band, thereby meeting the requirement

⁶ For ease of comparison, approximate euro equivalents of the exact Irish pound values are quoted here and elsewhere in the paper.

of “no marriage penalty”). Thus, in effect, only two thirds $[(35,600-21,600)/21,600=14,000/21,600]$ of a non-earning partner’s band was transferable.⁷ The stated objective was to arrive at a position after three years where each individual, whether single or married, has his/her own standard rate tax band which can be set off against his/her own income but cannot be transferred between spouses. By December 2001 the proportion of the band which was transferable had fallen to about one-third, remaining at that level after Budget 2003.

In this paper, we do not attempt to summarise the extensive, and often rather heated, debate that took place around the shift from an income-splitting system to a system with greater independence (and less transferability of rate bands) between husband and wife. Our aim instead is to bring new evidence on the likely outcomes linked with different policy choices in this area. With this in mind, we examine the potential size of labour supply responses to a full-scale individualisation of tax bands, and how this is affected by alternative uses of the incipient rise in tax revenue associated with restrictions on the transferability of the rate band. But first we explore how the changes in tax regime relate to changes in married women’s labour market participation over the past 35 years.

3. Tax Regime Changes and Trends in Labour Market Participation

How does the pattern and timing of changes in married women’s labour market participation relate to these major shifts in the tax treatment of couples? Figure 1 shows the participation rate for married women from 1971 to 1979 (the income aggregation period), from 1980 to 1999 (the income-splitting period) and from 2000 to 2005 (the “greater independence” period)..There is a strong upward trend in participation, but no evidence of an acceleration associated with the introduction of individualisation.

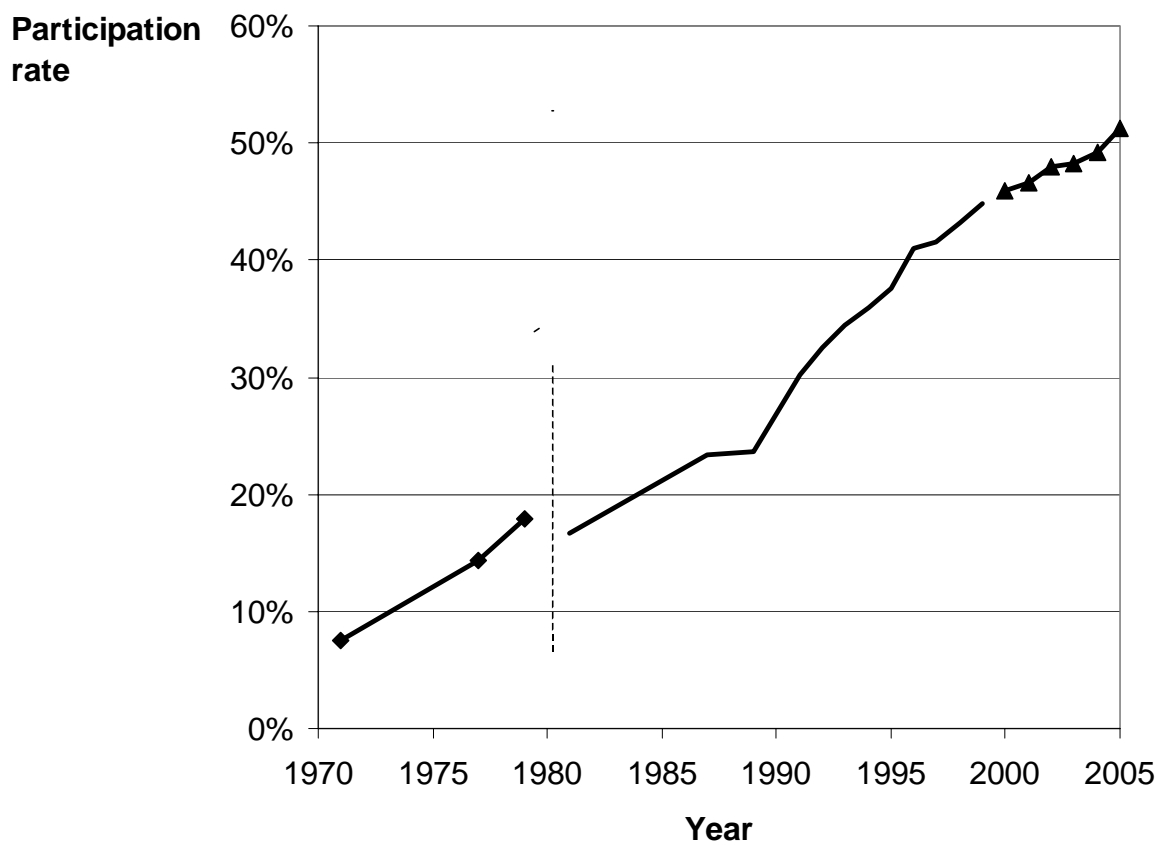
There are, of course, many other important influences on married women’s labour market participation. Slow growth in the 1980s and high unemployment undoubtedly dampened growth in participation. A “marriage bar” operated in the civil and public service⁸ as late as to 1973, whereby women were required to resign upon marriage (and not recruited if married). On Ireland’s accession to the European Economic Community (EEC), this section was deemed to be in direct conflict with the Treaty of Rome and the Equal Opportunity

⁷ In the immediate aftermath of the budget, a special Home Carer’s Allowance was introduced for couples with one partner staying at home to care for a child or children, an elderly person or someone with a disability. This had been announced in the manifesto of the major coalition party. There was no further increase in the level of this credit in the following years.

⁸ The bar affected not just civil servants, but also teachers and nurses.

legislation of the Community. Thus, in April 1973, the marriage bar was removed. European Community directives were also the driving force behind legislation on equal pay, and outlawing discrimination on gender grounds. Similarly, discriminatory provisions in the social welfare codes were removed, to a large extent because of European directives.

Figure 1: *Married women's labour force participation rate, 1971-2005*



Sources: CSO *Labour Force Survey*, various years; CSO *Quarterly National Household Survey*; and Census of Population 1971.

Of course, it could be that participation would have “flattened out” in the absence of changes in the tax treatment of couples, or that the full response to the tax changes is not yet apparent. It would be difficult, however, to construct a convincing counterfactual, given the complexity of the underlying forces driving participation over time. The construction of such counterfactual comparing individual and household labour market behaviour with and without a structural change in the income tax system is perhaps best addressed in a cross section setting, using microsimulation techniques. It is to this task that we now turn.

4. Structural Estimates of Labour Supply

4.1 A Framework for the Analysis

How can we derive estimates of labour supply responsiveness which can be used to analyse the impact of changes in tax and benefit policy? We need to be able to separate the impact of individual preferences, on the one hand, and budget constraints, on the other, in determining hours of work (cf. Blundell, 2001). First, we must model each individual's budget constraint – how much disposable income would they end up with for various choices of hours of work. Knowing their preferred choice, and the set of options available to the individual at the time of interview, it is possible to infer an underlying preference (or “utility”) function which can depend on a range of personal and family characteristics. Tax changes alter the options available, but the preference function can be used to identify the new optimum that the individual will choose. Policy reforms which change the budget constraint facing individuals and families can then be simulated. This separation of the influence of budget constraints (influenced by tax and welfare policies) and individual preferences can be achieved using what is known as a discrete choice structural model of labour supply. (See van Soest, 1995). The “discrete choice” element means that we estimate labour supply in blocks of, say, 4 or 8 hours per week, rather than at a very fine level of detail. This is particularly important when modelling the behaviour of couples, where estimation must search over a grid of all possible hours combinations for husband and wife. By focusing on the modelling of labour supply to the nearest 4 hours, say, the search grid can be made more manageable, which allows greater attention to be paid to the complexity of the budget constraint. A full description of the methods used can be found in Callan *et al.* (2003). Here we outline the broad rationale behind the approach, and present some of the labour supply elasticities calculated using the estimates.

Individuals are observed as having chosen certain hours of work, and the hourly gross wage that they actually earn can be calculated if they are in employment, or estimated if they are not presently in paid employment. The net family incomes they would obtain at other hours of work can then be simulated using routines for the calculation of taxes and benefits adapted from a tax-benefit model (in this case, *SWITCH*). The fact that each individual has chosen the observed package of income and hours of work is taken as indicating that this is the one which is preferred to all the other feasible choices, and maximises the family's

overall welfare.⁹ Information of this type on a large sample of families can be used to identify the underlying influences on family welfare which guide labour supply choices. Once these have been identified, it becomes possible to predict how individuals may behave if tax or welfare policy is changed in certain ways.

Two studies of this type are available in the Irish context. Callan and van Soest (1996) was based on data from a 1987 survey, a time when unemployment was close to 17 per cent of the labour force. Callan, van Soest and Walsh (2003) used data from the first wave of the Irish element of the European Community Household Panel, collected in 1994. By this time unemployment had fallen to just over 14 per cent of the labour force. There were a crucial difference in the nature of the data used in these two studies. The study using 1987 data was based on data on actual hours. The model estimated involved adjustments to take account of constraints on hours worked including involuntary unemployment. The later study had available to it information on *preferred* hours of work, which obviated the need for such adjustments. Despite these differences, the broad results were rather similar. For this reason we concentrate on outlining the more recent study in this paper, supplemented by a brief comparison of the main results from the earlier study.

4.2 *Labour Supply Estimates*

The discrete choice structural labour supply model constructed by Callan *et al.* (2003) captures important features of household labour supply behaviour from a policy point of view. The benchmark model approximates the budget constraint using multiples of 8 hours i.e., a standard day's work, so that possible hours choices range from 0 through 48 in steps of 8 hours. This yields a grid of (7 x 7 =) 49 possible combinations for a couple. Previous work by van Soest (1995) and Callan and van Soest (1996) found that estimates of labour supply elasticities were not much affected if a finer grid was used instead.

The model accounts for the full structure of the basic tax rules and the key feature that the social welfare system provides a floor to income. It captures simultaneously the participation decision and the decision on hours worked, by allowing for fixed costs of work. It takes account of the fact that wage rate information is not directly available for those who are not in employment.

The model was estimated using data from the 1994 Living in Ireland Survey, which included questions on desired hours of work from which it was possible to construct a

⁹ Intra-household distribution is not dealt with in this model, which treats the household as a unit.

measure of “preferred hours” for those in work, unemployed or out of the labour market. (For details, see Callan *et al.*, 2003). This information, collected only in the 1994 wave of the Living in Ireland Survey, is particularly valuable in trying to identify individuals’ preferences as regards hours of work.

Estimates of elasticities of labour supply for married men and married women are shown in Table 2. In the table, the (own- or cross-) wage elasticity of labour supply of a given group of people (husbands or wives) is defined as the percentage change in total desired hours of that group if all gross (before tax) wage rates (of husbands or wives) in that group rise by 1%. Note that all gross wage rates rise by 1%, but the tax system remains unchanged. The way in which net wage rates change is thus not fixed *a priori*, but driven by the existing tax system. On average, after-tax wage rates will change by slightly less than 1%, due to the progressive nature of the tax rules.

Many studies only consider or report elasticities for the average (“representative”) family. In a highly nonlinear model, however, these elasticities may not be a good guide to the consequences of wage changes for a heterogeneous population. Other studies consider average elasticities instead of elasticities of the average. The average elasticity can be seen as a weighted aggregate elasticity of hours worked, where more weight is given to people with lower desired hours. Some studies look at elasticities of hours worked *conditional upon participation*. For policy analysis, however, the effect on participation is at least as important as the effect on hours worked given participation, particularly for married women. The elasticities reported here take full account of the (positive) impact of the wage rate on the participation decision (with desired hours equal to zero for non-participants).¹⁰

Table 2: Labour supply elasticities for married men and married women with respect to wage changes
Elasticity of average preferred hours to change in wages

<i>Change in:</i>	<i>Husbands</i>	<i>Wives</i>
Male wage	0.25	-0.35
Female wage	-0.07	0.88
Both wages	0.18	0.48

Note: A 1% rise in the male wage leads to a 0.25% rise in average preferred hours of married men, and a fall of 0.35% in the average preferred hours of married women

Memo item: Average preferred hours for men was 35.8 and for women 11.1 hours per week.

For men, the own-wage elasticity is estimated at 0.25. That is, if all gross wage rates of the men in the sample increased by 1%, with women’s wage rates remaining unchanged,

¹⁰ Like the vast majority of labour supply elasticities quoted in the literature, these do not take account of wider repercussions in the labour market of the changes in labour supply.

the total desired hours of all men would increase by 0.25% . Most of this effect is due to increased participation: a rise in each husband's gross wage rate of 1% would induce an increase of the number of men willing to participate of almost 0.2 percentage points, i.e., by 0.21% of the actual participation rate of almost 90%. For women, the estimated own-wage elasticity is 0.88. The elasticity of the participation rate is 0.49, which again explains the largest part of the total labour supply elasticity. These estimates are well in line with the broad range of empirical findings of labour supply elasticities for other countries, even though, as explained above, a comparison is hampered by the fact that the large number of empirical studies are based on an almost as large number of elasticity concepts. When estimated cross-wage elasticities (-0.07 for men, ---0.35 for women) are taken into account, the model predicts that a general increase in wages of 1% would see desired hours rise by 0.18% for men, and by 0.48% for women.

Thus, in line with other findings for Ireland (e.g., Doris, 2001) and internationally, the labour supply of married women is significantly more responsive to an increase in their wage rate than men (with respect to the male wage rate). For both men and women, increased participation accounts for the major part of the response, with increases in hours of work playing a lesser role.

The analysis deals with desired or preferred hours of work at the wage rate the individual currently commands. This allows for considerable simplification over analyses which must deal with the potential for involuntary unemployment or actual hours of work which diverge from preferred hours. It can also be seen as allowing for maximum flexibility in labour market response. In some circumstances changes in desired hours will not translate into changes in actual hours because of constraints on individual behaviour (e.g., having to choose between full-time and part-time work; or being involuntarily unemployed). Nevertheless, it is of interest that the own-wage elasticities for men and women reported by Callan and van Soest (1996), based on 1987 data on actual hours and incorporating modelling of involuntary unemployment and constraints on hours, are quite similar to those reported here (0.15 for men, 0.67 for women)

5. Simulating the Labour Supply Impact of Tax Changes

5.1 Labour Supply Response to Tax Policy Changes

Callan *et al.* (2003) analyse the impact of changes in tax rates, tax free allowances and wider rate bands on labour supply, as well as the impact of increased independence in the

taxation of husbands and wives. The structural model is particularly useful for this purpose, since it accounts for the complete structure of the tax system and cash benefits, including any “kinks” or “jumps” in budget constraints.¹¹ Moreover, the model predicts the effects on labour market participation – whether or not an individual seeks paid work – as well as the distribution of hours worked for those in paid employment.

The way in which the effects are predicted is very similar to the method of computing the elasticities in Section 4. Using the parameter estimates, the labour supply of each individual under the actual 1994 tax rules is predicted. The simulation is then repeated using the tax rules after the reform in question. Comparing the two outcomes gives the predicted changes. For the simulation after the reform, it is assumed that gross (pre-tax) wage rates remain the same.

In Section 5.2 we compare the labour supply effects of equal-valued tax cuts through the four main routes actually used to cut taxes over the past decade and a half: the top and standard rates of tax, the width of the standard rate tax band, and the size of the basic personal allowance. Section 5.3 considers the impact of a structural reform, in which the transferability of allowances between husbands and wives is reduced. Alternative uses of the incipient rise in revenue – increasing child benefit, or reducing income tax rates – are contrasted.

5.2 Estimated Labour Supply Responses to Alternative Tax Cuts

In this sub-section, we ask which form of tax cut does most to stimulate aggregate labour supply, and how does this vary as between the participation of husbands and wives? In order to answer this question, we simulate the labour supply response to four different types of income tax cut: a cut in the standard rate of tax, a cut in the top rate of tax, a rise in the personal allowance, and a widening of the standard rate band. Each form of tax cut is scaled to have approximately the same Exchequer cost on a static basis i.e., before any behavioural response.

Table 3 shows the estimated changes in participation rates for men and women in response to various tax policy changes. A cut in the standard rate of tax of just under 3 percentage points leads to a rise of about half a percentage point in both male and female participation rates. An increase in personal allowances (with similar exchequer cost) has very

¹¹ The analysis, like that in most international studies, does not include non-cash benefits such as the medical card. For a path-breaking US study analysing participation in both cash and non-cash programs see Keane and Moffitt (1998).

similar effects. Changes to the top rate of tax or to the standard rate band, however, have rather different consequences. A cut in the top rate of tax of more than 6 percentage points is estimated as leading to a rise of about 1 percentage point in the participation rate for married women, but only to a very small rise in the participation rate for married men (0.1 percentage points). Widening the standard rate band leads to similar, but marginally greater changes in participation rates.

Table 3: *Response of the Labour Force Participation Rate to Selected Tax Cuts*

<i>Tax Cut Option</i>	<i>Change in husbands' participation rate</i>	<i>Change in wives' participation rate</i>
Standard rate cut by 2.8 percentage points	+0.5	+0.6
Top rate cut by 6.3 percentage points	+0.1	+1.0
Standard rate band up by Ir£2400 from Ir£8200	+0.2	+1.1
Personal allowances increased by Ir£465 from Ir£2350	+0.5	+0.5

Note: All options had an Exchequer cost of about £200m per annum (€250m), including the impact on single persons.

The overall change in participation (male and female combined) is rather similar across the different options. The major difference is in the sex distribution of the change in participation. A cut in the top rate of tax, or a widening of the standard rate band, prompts a greater increase in female participation and much less in male participation. A cut in the standard rate of tax, or an increase in personal allowances, leads to similar increases in participation rates for both sexes.

The overall labour supply response includes not only changes in labour market participation, but also changes in desired hours for those who were initially in employment or seeking employment. As with the participation response, the aggregate (male and female combined) labour supply response is rather similar across the options, with a rise in average desired hours of 0.2 to 0.3. The differences between the options are also similar to those observed for the participation response: a cut in the top rate of tax or a widening of the standard rate band give rise to a much greater response by married women than by married men. There is little difference between the sexes in the response to a standard rate tax cut or a rise in personal allowances.

5.3 Labour Supply Response to Alternative Reforms of Tax Treatment of Couples

Table 4 shows the impact of alternative ways of implementing increased independence in the tax treatment of husbands and wives. Option (A) simply involves the elimination of transferability of the standard rate tax band, and would generate something over €250m per annum in extra tax revenue.¹² Option (B) returns this revenue to taxpayers, via proportionate cuts in the standard and top tax rates. Option (C) is also revenue neutral, but the incipient rise in revenue is used to fund an increased child benefit.

Table 4: Response of Husbands' and Wives' Participation Rates to Increased Independence in Tax Treatment of Married Couples

<i>Change in tax structure</i>	<i>% point change in husbands' participation rate</i>	<i>% point change in wives' participation rate</i>	<i>Net change in Exchequer revenue as estimated by SWITCH on full sample¹³</i>
(A) Standard rate band made non-transferable	-0.5	+1.8	+€267m
(B) Band non-transferable, tax rates cut to 25.4% and 45.1%	-0.1	+2.6	-€10m
(C) Band non-transferable, Child Benefit increased by 69%	-0.9	+1.6	+€1m

A notable feature of option (A) is that it gives rise to a net increase in labour market participation (a fall in married men's participation being more than offset by a rise in the participation of married women), while at the same time actually increasing net revenue for the Exchequer. Options (B) and (C), returning this revenue via general tax cuts or via child benefit, are designed to be approximately revenue neutral.¹⁴ Option (B), combining non-transferable bands with cuts in tax rates, gives rise to a sharp rise in married women's participation, and leaves men's participation almost unchanged. Option (C), using the revenue from restrictions on transferability to fund an increased child benefit, also boosts married women's participation, but leads to a fall in men's participation.

What about the total labour supply response, in terms of desired hours of work? Under option (A), the rise in average desired hours of work for women is almost offset by a fall in desired hours for men. Under option (B), which includes a significant cut in tax rates as well, the response of married women is more positive, and that of married men is less

¹² All calculations are undertaken in a 1994 setting.

¹³ In euro terms, the exchequer costs were about €266m, €10m and €1.3m for options A, B and C respectively.

¹⁴ As noted earlier, this is revenue neutrality on a static basis; increases (falls) in participation/hours would give rise to increased (reduced) revenues.

negative. As a result, the overall labour supply response for married couples is positive – and, importantly, the response of single people, not simulated in the present framework, would also be positive.. Under option (C), the gain in tax revenue arising from non-transferability is applied to fund a rise in child benefit. This gives rise to a fall in male labour supply which is only partially offset by a rise in the labour supply of married women.

Overall, these results suggest that a package involving full individualisation of tax bands, and a revenue-neutral reduction in tax rates, would lead to a rise in married women’s participation of between 2 and 3 percentage points. While this represents a stronger response than that to standard forms of tax cut (rate cuts, increased allowances or band widening) it is still quite modest, when compared with the strong upward trend in women’s participation – a rise of 40 percentage points over the past thirty years. It should also be remembered that the actual package introduced included provisions for a Home Carer’s Allowance for women with low levels of labour market involvement because of child and/or elder care, and only partial individualisation of the bands. Each of these factors would reduce the size of the overall impact. If the package were to be combined with increases in child benefits, rather than reductions in tax rates, the overall impact on married women’s participation could be further attenuated.¹⁵

6. *Interpreting the Irish Experience*

The lessons to be learned from the Irish experience are of two types. First, there are findings as regards the impact of tax policy on married women’s participation; and on the differential impact of alternative tax cuts on overall participation in the labour market. Second, there are a number of interesting findings in terms of how the policy change in 2000 was introduced, how it was initially perceived, and how public and interest group perception of the change has altered in the years since its initial introduction.

Our analysis has found that, in the Irish context, a substantial move from an “income-splitting” system towards a more independent income tax treatment of couples has a significant impact on the labour market participation of married women. We also examined different forms of tax cut (focused on tax rates, on allowances or on the width of the standard rate tax band) and found that of these, widening of tax bands had by far the greatest impact on married women’s labour participation and hence on total labour supply.

¹⁵ Here we are simply attempting to describe the likely consequences of various policy combinations; no judgement as to which is to be preferred is implied.

However, these factors have a relatively small role to play in explaining the sharp trend increase in married women's labour market participation over the past 30 years. Possible explanatory factors include wider social changes, including expansion of second and third level education. But there is also a substantial role to be played by another economic factor: rising real wages, at given levels of education, make participation in the paid labour market more attractive year by year. The introduction of equal pay and anti-discrimination legislation, and the abolition of barriers such as the marriage bar for the civil service, also enhanced the attraction of labour market participation.

Turning to the issues of policy introduction, presentation and management, I try first to set out the facts of the matter. It is noteworthy that during the 1990s the idea of introducing greater independence into the tax treatment of couples was discussed in a number of official reports and documents. (NESC, 1991; Second Commission on the Status of Women, 1993; Department of Social and Family Affairs, 1999). The issues were not, however, the subject of widespread debate in either political or public fora.¹⁶ Thus, when the Minister for Finance made the announcement in his Budget 2000 speech (December 1999) it was entirely unexpected, not just by the opposition and by society at large, but also within his own party.

With a strong economy, and public finances in very good shape, the Budget had been expected to involve perhaps the largest packages of expenditure increases and tax cuts in Irish history. It delivered on this expectation. But a furore over the tax changes¹⁷ threatened to nullify any advantage to the government from this. The opposition seized on this aspect of policy as "anti-family" and promised to reverse it. A variety of commentators and interest groups came out strongly against the change. Within a few days the government was forced to introduce a counterbalancing measure, promised in its manifesto, which gave a tax credit to those involved in caring for children and/or the elderly (the Home Carer's Allowance).

In the space of a few months, the position had stabilised. A new social partnership agreement had been under negotiation, and the agreement which emerged contained the following paragraph in the section on taxation:

The social partners support the policy of establishing a single standard rate income tax band for all individual tax payers.

¹⁶ There was an academic/policy conference in October 1999 at which a paper touched on the issues, noting in particular the difficulty of attaining a standard rate band for single persons as large as that in the UK while maintaining the "income-splitting" system.

¹⁷ The matter was further complicated by the fact that the overall tax and welfare package was very strongly tilted towards the top of the income distribution.

By the time of the next Budget, there was not much comment on the further extension of “individualisation” of the standard rate band.

How should this sequence of events be interpreted? Here I focus on three aspects of the stormy debate which centred on the individualisation of the standard rate band.: the alleged “anti-family” nature of individualisation; the impact on married women’s participation choices; and whether or not individualisation necessarily involved a regressive impact.

6.1 Individualisation and Family Policy

During the debate about individualisation there was a tendency to view the pre-reform tax treatment of married couples – which involved full transferability of bands and allowances - as a system that was “pro-family”.¹⁸ By contrast, the new individualisation arrangements were characterised as being “anti-family” in their effect. On this view, individualisation was associated with individualism,¹⁹ whereas a family-centred policy must involve full transferability of allowances and bands between husbands and wives.

Let us tease out some of the elements underlying this approach. As we have seen, the main rationale put forward for the income-splitting system was that it would provide support for one-income families “particularly where a married woman elects to care for the family on a full-time basis at home rather than take up work outside the home”. This can be viewed as putting the emphasis on the provision of a tax subsidy for childcare undertaken by married women in the home. But, as Fahey (1998) suggests, alternative uses of the resources – including the possibility of a greatly increased Child Benefit – could “serve the purposes of family policy a great deal more effectively and efficiently than does the present approach, as far as income tax and married couples are concerned”.

These considerations suggest that individualisation does not necessarily involve an orientation towards individualism. Individualisation can form part of a package of measures reorienting and strengthening support for families. The retention of full transferability could be an inefficient and ill-targeted use of resources. Much depends, therefore, on the make-up of the overall package of which individualisation forms a part.

¹⁸ The system could also be described as one involving “income-splitting”, or doubled personal allowances and rate bands for married couples.

¹⁹ This view is expressed by, among others, the former Taoiseach John Bruton, who referred to “pure individualism, and its associated political programme of individualisation” in a speech of 16 August 2004 (Fine Gael website).

6.2 Individualisation and Married Women's Labour Market Participation

Improving the financial incentive for married women to take up employment was one of the explicit aims of the individualisation measure. One of the most heated elements of the debate concerned whether or not this would represent a good outcome for Irish society.

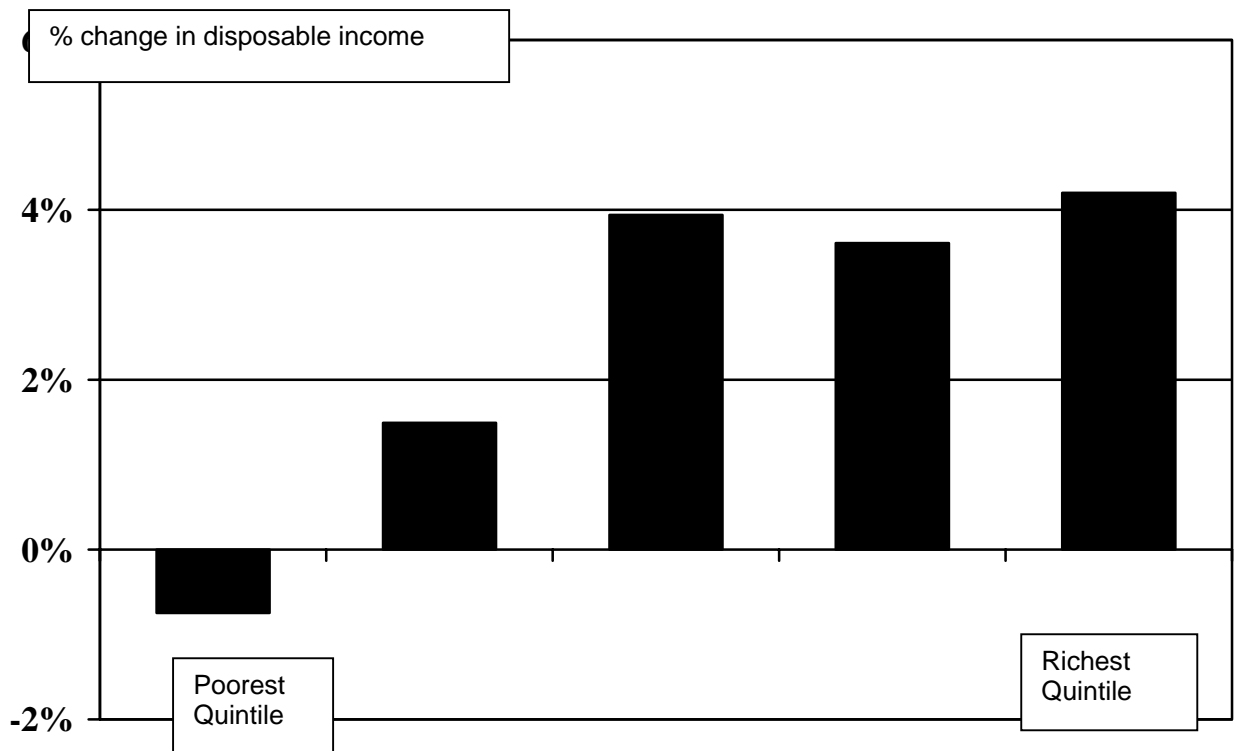
“Individualisation is a naked attempt to increase female participation in the labour force and to coerce women, who might otherwise opt to work at home while their children are young, into the labour force.” (Deputy J. Mitchell, Dáil Debates, 27 February 2001).

There was little discussion of exactly how much of an increase in female participation might be expected, but the impression gained from some of those opposed to individualisation was that a great many women would be “forced into the labour market”, as they put it. We have seen that both time series evidence, and cross-section modelling suggest a much more modest impact of the tax regime change on women's labour market participation.

6.3 Individualisation and the Distribution of Income

The first stage of individualisation involved not just a structural change in the treatment of couples, but a substantial widening of the standard rate band for single people and two-earner couples. In subsequent years, there was some further widening of the band, but also very substantial increases in child benefit. Evaluation of the impact of “individualisation” depends critically on what benchmark is used to assess the impact. I have argued elsewhere that a “distributionally neutral” benchmark, provided by a wage indexed budget, is of considerable value. (Callan, 2006)

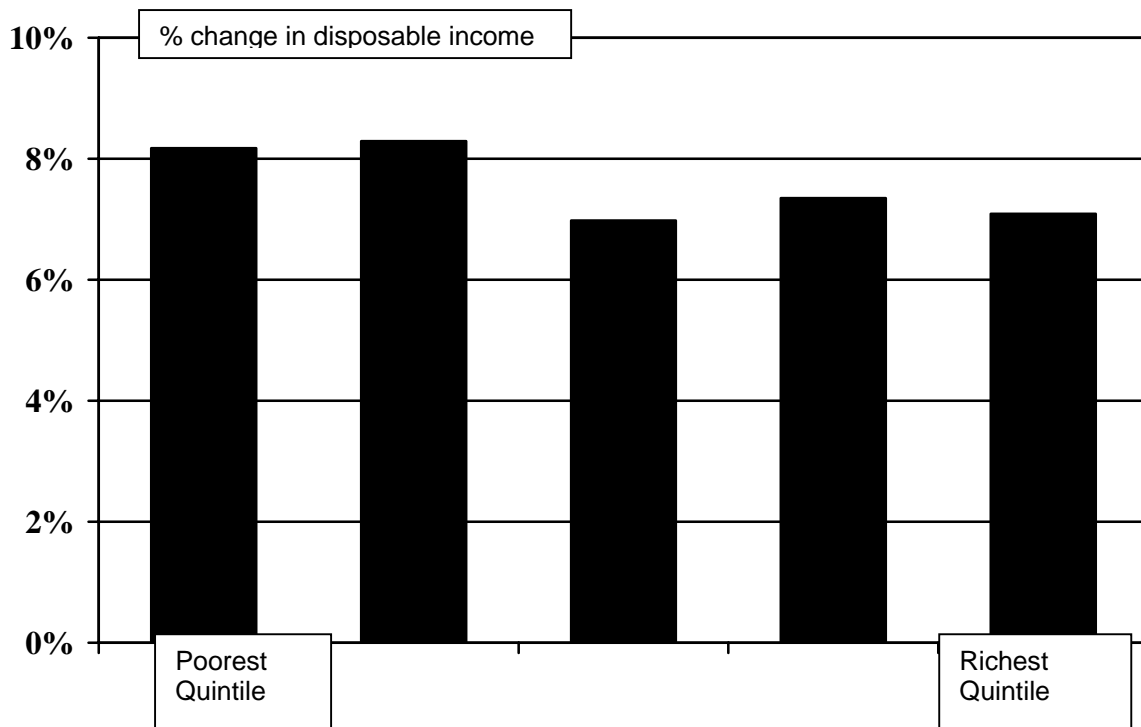
Figure 2: *Distributive Impact of 2000 Policy Relative to 1999 Policy Indexed to Earnings Growth*



Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or “quintiles”

Here I provide two pictures of the impact of individualisation. The first (Figure 2) is simply the impact of Budget 2000, in which individualisation was introduced. It shows that the benefits of Budget 2000’s tax and welfare package were skewed towards middle and upper income groups. The second (Figure 3) is the impact of Budget 2004 assessed against the pre-individualisation policy (Budget 1999) indexed in line with wage growth. This allows an assessment of individualisation in the context of the overall policy package which has evolved over the past three or four years. The net effect is very even across the income distribution, with a slight “pro-poor” bias.

Figure 3: *Distributive Impact of 2004 Policy Relative to 1999 Policy Indexed to Earnings Growth*



Note: Families ranked by income per adult equivalent and sorted into 5 equal-sized groups or “quintiles”

7. Conclusions

Analysis of a change in the tax treatment of Irish couples from “income-splitting” towards greater independence finds statistically significant and identifiable effects on married women’s labour market participation. These effects are large relative to the effects on participation of income tax cuts of various types. But they are small in comparison to the strong upward trend in participation, driven by such factors as rising real wages, rising education levels, anti-discrimination legislation and the removal of institutional obstacles to married women’s participation. It is also the case that different types of tax cut can have quite different effects on the participation of husbands and wives.

The lines of influence between the tax treatment of couples and married women’s labour market participation in Ireland run in both directions. As well as the impact of policy on participation, which has been econometrically identified and discussed above, the strong rise in participation has made possible changes in policy which were considered “unthinkable” not so long ago.

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