Making Work Pay More: Recent Initiatives

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Making Work Pay More: Recent Initiatives

Abstract

This paper examines the financial incentives to work implicit in the Irish tax and benefit system, focusing in particular on incentives facing those who are unemployed and in receipt of Jobseeker's Benefit or Jobseeker's Assistance. The results, based on an analysis of current incomes, benefits and taxes, suggest that more than eight out of ten of these unemployed jobseekers would see their income increase by at least 40 per cent upon taking up employment. Fewer than 3 per cent of these individuals would, in the short-term, be financially better off not in work. The risk of facing weak financial incentives to work is higher for unemployed persons with a spouse and children, as the income support goal of the welfare system means that they tend to have higher welfare payments. However, even among that group, fewer than 1 in 15 would be financially better off not working. Our analysis shows that a recent policy initiative, the Back to Work Family Dividend, announced in Budget 2015, clearly improves the immediate financial incentives to work for this group.

How do these findings change when account is taken of the fact that many unemployed people would qualify for a Medical Card? Those returning to work from long-term unemployment may qualify for retention of a medical card for three years, but might lose it on income grounds thereafter, as might those returning to a job from an unemployment spell of less than a year. We examine this issue using average values for Medical Cards, based on the usage by current recipients. The overall findings on work incentives are not substantially altered on this basis, even though the special scheme for retention of medical cards is not taken into account. However, in individual cases where families make much greater than average use of a Medical Card (e.g., because of chronic illness), there may be greater impacts.

1. INTRODUCTION

For many years, the OECD's *Jobs Strategy* publications have encouraged the design and reform of tax and benefit policies to ensure that they maintain strong financial incentives to work - in other words, to ensure that work pays well. For example, in its Jobs Study some twenty years ago the OECD (1994) recommended reform of unemployment and related benefit systems, and their interaction with the tax system, "such that societies' fundamental equity goals are achieved in ways which impinge far less on the efficient functioning of labour markets". Again in recommending tax and benefit reform in the context of employment challenges, the OECD (1998) argued that "if work does not pay, people will be more reluctant to work". More recently when promoting inclusive growth, the OECD (2014) suggested that beyond a certain level, generous long-term benefits can unduly reduce incentives to work.

The issue of work incentives in the context of a modern welfare system have been discussed over many decades and continue to be discussed. A key question is how to measure these incentives. In this context, Blundell (2011) has emphasised that

> *to understand how taxes and benefits might affect labour supply choices, we need to measure the effective work incentives implicit in the tax and benefit system.*

With that in mind, a number of recent contributions to the ESRI's Budget Perspectives conference have sought to address the question: Does it pay to work in Ireland? Papers by Callan et al. (2012), Callan et al. (2013), and Savage et al. (2014) found that for a very large majority of jobseekers in Ireland, there was significant financial gain associated with taking up employment, even without taking into account the longer-term income effects of a career in employment. The current paper considers some recent policy initiatives that are designed, not simply to make work pay, but to make work pay more. In particular, the Back to Work Family Dividend (BTWFD) scheme has been designed to improve the financial incentive to move from unemployment into employment for jobseekers with children, a group previously identified as being at high risk of facing high replacement rates. In this paper, we examine the impact of the BTWFD on the financial incentive to work in Ireland. We also briefly discuss the potential impact of the new Housing Assistance Payment (HAP) on the incentive to work.

An aspect of the financial incentive to work that is often omitted from analyses of work incentives is the provision of means-tested non-cash benefits. In Ireland, the Medical and GP Visit Cards, which provide entitlement to a number of medical services to low income individuals and families, are important non-cash benefits

to those who receive them and are usually available to all who are unemployed and their dependants. The means-tested nature of the benefit means that a move from unemployment into employment can result in the loss of the card. Consequently, it has the potential to have a significant effect on the financial incentive to take up employment. Another key contribution of this paper is to examine whether the inclusion of the Medical and GP Visit Cards significantly alters the pattern of financial work incentives. While not explicitly designed to improve work incentives, providing free GP care to all children under the age of six is another recent policy initiative that can affect the decision to work. We also examine the effect of this policy on work incentives in Ireland.

With a small number of exceptions, the analysis in this paper is concerned with the work incentives facing the unemployed population who are in receipt of a Jobseekers payment. The reason for focusing on the unemployed is straightforward; this is a group which is, by definition, seeking paid employment, so that the financial incentive issue is particularly relevant. We restrict the analysis to those receiving a Jobseeker payment so that we can examine if receiving such a payment can create financial disincentives to work. Those who are not receiving a Jobseeker payment, for example young adults whose parental income rules them out of receiving a Jobseeker payment, are typically facing a stronger incentive to take up employment than those who do receive a payment. Thus, in identifying high replacement rates it is helpful to focus on those who are in receipt of payment. The work incentives facing other groups of the population, such as those in receipt of One Parent Family Payment or those who classify themselves as being engaged in "home duties", will be examined in future work.

In the sections that follow, we use an internationally accepted method of exploring financial incentives to work, namely, by estimating the replacement rates to measure the financial work incentives implicit in the Irish tax and benefit system. Section 2 describes this measure in detail and discusses the data requirements for the analysis. Section 3 updates previous work by examining the current work incentives implicit in the 2015 tax and benefit system in Ireland. Section 4 then examines the effect of two recent policy initiatives on financial work incentives. In Section 5, we calculate the impact of the Medical Card and GP Visit Card on replacement rates, and examine the impact on work incentives of the introduction of free GP care to children under six years of age. Finally, in Section 6 we draw together the main findings.

2. MEASURING FINANCIAL INCENTIVES TO WORK[1]

2.1 Replacement Rates: Meaning and Measurement

The replacement rate is the most commonly used single measure of the incentive to be in work. It measures the proportion of in-work income which would be retained or replaced (e.g., by jobseeker payments) when out of work. Replacement rates are in widespread use both in empirical studies and in theoretical models of the labour market. They are also widely used in policy debate, both nationally (e.g., NESC, 2011) and internationally (e.g., OECD, 2014). For all of these reasons, it is the replacement rate measure which is the focus of the current study.[2]

BOX 1: REPLACEMENT RATES

The replacement rate shows the proportion of income when employed that would be replaced when out of work.

$$Replacement\ Rate = \frac{Out - of - Work\ Family\ Disposable\ Income}{In - Work\ Family\ Disposable\ Income}$$

For example, an individual might find that his or her family income when unemployed is €180 per week, but that on taking up a job that disposable income would rise to €300 per week. The replacement rate in this situation would be 60 per cent. A higher replacement rate indicates weaker financial incentives to take up or remain in employment.

We examine the incentives facing both partners in a couple, taking each person in turn. When examining incentives facing one spouse, we hold the labour market participation of the partner constant. In so doing, we take into account the overall impact of the change on *family* income. A narrow focus on the individual's own disposable income[3] would fail to take account of the possible impact of an individual's taking up employment on the social welfare entitlements and/or income tax liabilities of his or her spouse or partner. Adult children are regarded as separate decision making units, but the impact of the household means test ("benefit and privilege") applying to young adults living with their parents is taken

1 This section draws in part on Savage et al. (2014), where more details on the measurement of the financial incentives to work can be found.

2 An alternative measure that could be used here is the Participation Tax Rate (PTR). Savage et al. (2015) use the PTR to measure financial incentives to move between unemployment, part-time employment and full-time employment.

3 Disposable income is cash income from all sources - including wages and salaries, profits, pensions, interest, dividends and welfare payments - net of taxes, levies and social insurance contributions.

into account, as are the lower rates of payment for Jobseeker's Allowance for those aged under 26.

Both nationally and internationally, disposable income is by far the most common metric used to assess financial incentives to work. For example, the OECD statistics on replacement rates and those produced by the Institute for Fiscal Studies[4] focus on disposable income arising from pay net of tax and social insurance contributions, combined with cash benefits (which may include housing-related benefits as well as personal and child-related welfare benefits). It is widely recognised that other factors, notably childcare costs and travel to work costs, may also affect the net reward from employment. Callan et al. (2013) and Savage et al. (2014) examined this issue in some detail, using data on the pattern of childcare costs from the Survey on Income and Living Conditions (SILC) to assess the likely impact of this additional factor on the distribution of replacement rates. They found the while fixed costs of work worsened the financial incentive to take up employment for unemployed individuals, the impact was quite small. Childcare costs, for example, had a very limited effect on replacement rates for two reasons:

- a large majority of unemployed jobseekers did not have children.
- For many of those jobseekers with children, childcare costs would not necessarily be incurred for a return to work because the spouse or partner of the unemployed person was already engaged full-time in caring for the child or children.

In the present study, therefore, we do not seek to include estimates of childcare costs, focusing instead on extension of our modelling approach to include new feature such as the Back to Work Family Dividend, and the impact of including the value of a Medical Card or GP Visit Card on the balance between resources in and out of work for jobseekers.

For people who are not currently in paid work, a key issue in the replacement rate calculation is how much they could expect to earn if they were employed.[5] The broad approach used here is in line with empirical studies of labour supply, which use a predicted wage taking into account wage-relevant individual characteristics. The key point is that jobseekers vary widely in the wage that they

[4] Adam et al. (2006) briefly examine the potential impact of childcare costs on replacement rates; but their main results are for disposable income. Both earlier and later papers by IFS authors (e.g., Hood et al., 2014; Adam and Browne, 2010) focus on disposable income in their empirical implementation.

[5] The focus here is on the wage which could be expected in the short run. Individual's decisions regarding employment will also be influenced by the likely time path of earnings arising from taking up employment.

can reasonably expect to attain in the labour market, and that a method which allows for this is more realistic than a "one wage fits all" approach.[6]

Wage equations are estimated separately for four categories:[7,8] single women, single men, married women and married men. This approach allows not only for gender differences in pay, but also for the very widespread finding that there is a "wage premium" attached to marriage for men, and, commonly though not universally, a "wage penalty" attached to marriage for women. (The sources and interpretation of such premia are discussed in Pollmann-Schult, 2011). The key variables used to predict hourly wages are age (and its square, to allow for a positive but decreasing impact) and five levels of educational qualification. The minimum wage for those under 18 years of age, which at €6.06 is 30 per cent below the general minimum wage, is used as a floor for predicted wages.[9] Weekly earnings are generated on the basis of a job with a 40 hour week; this is the modal value reported by full-time workers in SILC 2010. The financial incentives to work examined in this analysis therefore reflect the incentives to take up full-time employment.

There is substantial evidence that spells of unemployment or spells out of the labour market have, on average, a negative impact on the wages which can be commanded in the labour market (see Arulampalam (2001), Gregory and Jukes (2001) and McGuinness et al. (2009) for example). Our approach in this paper is to estimate the relationship between wages and characteristics (age, education level, marital status, gender) for those who are in employment. We then estimate a wage for the unemployed based on the wage return to these characteristics, and, based on the results of the previous literature, allow for a 10 per cent reduction in wages associated with a spell of unemployment or a spell out of the labour market.

In looking at replacement rates it is essential to be aware of two different perspectives. From one perspective, the replacement rate provides a measure of the financial incentive to work; the lower the replacement rate, the greater the incentive to work, other things being equal. Looked at from the point of view of

6 The OECD, for example, often presents Replacement Rates assuming that unemployed individuals receive a wage equal to a certain percentage of the national average wage, see OECD (2010) for example.

7 In earlier work, Callan et al. (2012) used a particular technique – a selection corrected regression or Heckman correction – to take account of the fact that there might be differences in unmeasured characteristics of unemployed and employed populations which would affect the wages which could be commanded. The approach used here seems better able to capture the key features of expected wages, as detailed in Savage et al. (2014).

8 The actual wage of those in employment is recorded in the SILC data, so actual wages are used in the replacement rate calculation for employees. Estimated wages are therefore only required for those not currently in employment.

9 We allow for the fact that wages cannot be perfectly predicted. An error term, drawn from the normal distribution, is added to the predictions to ensure that the "spread" of predicted wages is in line with what is indicated by the estimated wage equation.

the income support goal, however, a higher replacement rate is seen as improving the level of support and degree of insurance afforded to those who become unemployed. Policy must be designed to strike a balance between these perspectives, in a context in which there is considerable variation both in needs (related to family size, for example) and in potential wages (which vary in response to factors such as productivity, skills and experience rather than needs). The need to balance the potential conflicts between the income support and work incentive goals means that careful monitoring of both the income support and work incentive outcomes is needed.

2.2 Data and the SWITCH Tax-Benefit Model

The underlying data used to estimate replacement rates come from the CSO's *Survey on Income and Living Conditions 2010*. Basing results on a representative sample of the population means we avoid problems associated with using "example households" to illustrate replacement rates that people in Ireland face in reality.[10] We focus here on the working-age population, and their dependent children. The data are adjusted for growth (or decline) in average employee and self-employed incomes since 2010, and for the numbers in employment and unemployed in 2015. To account for the structure of the relevant population, weighting factors have been estimated using the CALMAR program. This programme is widely used by National Statistical Institutes (the equivalent of Ireland's Central Statistics Office) and by Eurostat to ensure good representation of the income tax base, and to improve an already very good representation of the social welfare client population. The adjustment methods are described in Keane et al. (2014).

Our main focus is on those who are unemployed and in receipt of Jobseeker's Benefit or Jobseeker's Assistance. Estimates from the SILC data suggest that about 163,000 individuals match these criteria (unemployed, receiving a Jobseeker payment, not in paid work). This is substantially lower than the widely quoted headline number from the Live Register, currently close to 340,000. The difference between the two is explained by the facts that the Live Register includes almost 70,000 individuals who are engaged in casual or part-time work,[11] and a further 35,000 individuals are on the Live Register because they are "claiming for credits" or otherwise not applying for payment. The 163,000 unemployed jobseekers in SWITCH represents over 70 per cent of the remaining 235,000 individuals on the Live Register who are not in employment and who are claiming for a jobseekers payment. However, the Live Register includes all those

[10] See Callan et al. (2012) and Savage et al. (2014) for more discussion and critique of the "example households" approach.

[11] Marginal effective tax rates on additional earnings are a more appropriate measure of incentives than a replacement rate for this group.

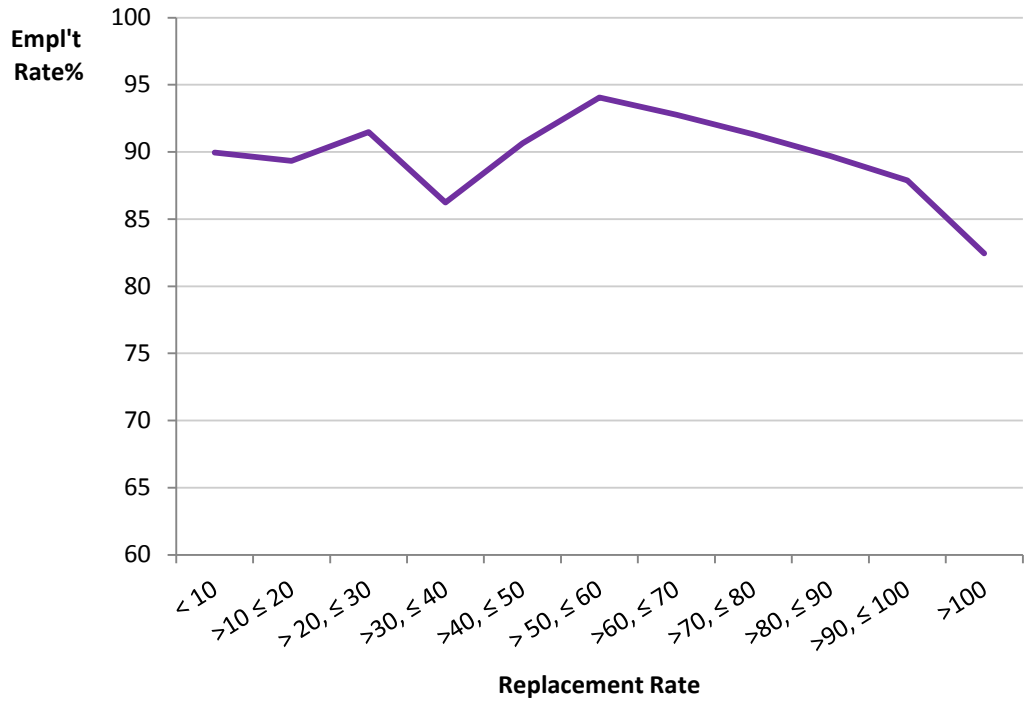
who *claim* a payment, but a substantial number of those claims do not succeed. When these factors are taken into account, it seems likely that the SILC-based estimate covers close to 80 per cent of the relevant population.

3. DISTRIBUTION OF REPLACEMENT RATES

Before examining the distribution of replacement rates in Ireland in 2015, it is worth examining how the employment rate[12] changes as the replacement rate increases (Figure 1). At replacement rates up to around 70 per cent, the employment rate varies between 85 per cent and 95 per cent, often in the 90 per cent to 95 per cent range, but shows very little relationship with the replacement rate. It is only at higher replacement rates (above 70 per cent) that the employment rate remains below 90 per cent and gradually declines to below 85 per cent. This pattern suggests that once the replacement rate is below a certain level, it has very little effect on the decision to work. Higher replacement rates, above 70 per cent, seem to have some negative impact on employment participation. However, of those individuals with a replacement rate greater than 100 per cent, Figure 1 shows that over 80 per cent, or close to five out of six, of these individuals are in employment. As discussed in Savage et al. (2014), a number of factors other than the replacement rate affect participation in employment. Dynamic gains over the longer term in employment, and non-financial rewards from working life are two such reasons. The results in this analysis are based on static replacement rates, and should therefore be interpreted in this context.

[12] Employment rate here is defined as the number of employees as a proportion of all employees or those seeking work.

FIGURE 1 **Employment Rate by Replacement Rate Category, 2015**



Source: SWITCH.

Note: Employment rate defined as the number of employees as a proportion of the number employees plus the number looking for work.

We look first at the overall distribution of replacement rates for those who are unemployed on JA/JB. Table 1 also includes the distribution of replacement rates for employees. The majority of individuals, whether employed or searching for employment, face strong financial incentives to work. More than 50 per cent of employees, and more than 60 per cent of unemployed jobseekers, face replacement rates of less than 50 per cent. As shown in Figure 1, it is only at replacement rates above approximately 70 per cent that we begin to observe a decline in the employment rate. In what follows, we therefore focus on the frequency at which individuals face these high replacement rates.

TABLE 1 Full Distribution of Replacement Rates, Ireland 2015

Replacement Rate Category	Unemployed on JA/JB	Employees	Both
	%	%	%
≤ 30	17.1	17.4	17.3
>30, ≤ 40	23.3	15.1	15.8
>40, ≤ 50	20.2	20.2	20.2
> 50, ≤ 60	10.5	17.2	16.6
>60, ≤ 70	10.5	13.9	13.6
>70, ≤ 80	7.3	7.9	7.9
>80, ≤ 90	5.4	4.8	4.9
>90, ≤ 100	2.8	2.1	2.1
>100	2.8	1.4	1.5
Total	100	100	100
Estimated sub-population:	163,000	1,581,000	1,744,000

Source: SWITCH.

Table 2 and several others which follow, may be read as follows: 18.3 per cent of the unemployed have a replacement rate of more than 70 per cent, while 11 per cent have a replacement rate of more than 80 per cent. Each figure represents the proportion of the population with a replacement rate above a particular value; as they are cumulative totals, the figures are not additive and must be equal to or less than the proportion in the cell directly above.

Table 2 indicates that almost 80 per cent of unemployed individuals have a replacement rate of less than 70 per cent. These individuals would see their incomes rise by at least 43 per cent if they were to obtain a job, at a wage corresponding to their qualifications. The "risk" of facing a high replacement rate (over 70 per cent) is greater for the unemployed than for employees. Given the relative sizes of these groups, however (1,581,000 employees as against 163,000 unemployed) most of those who are facing high or very high replacement rates are in fact in employment, as shown in Figure 1. For example, of those facing very high replacement rates (90 per cent or more) about 54,000 are employees while about 9,000 are unemployed.

TABLE 2 Distribution of High Replacement Rates, Ireland 2015

Replacement Rate Category	Unemployed on JA/JB	Employees
	%	%
>70	18.3	16.2
>80	11.0	8.3
>90	5.6	3.4
>100	2.8	1.4
Estimated sub-population:	163,000	1,581,000

Source: SWITCH.

Unemployed individuals with children are more likely to face high replacement rates than those who do not have children. Table 3 presents results on the distribution of replacement rates for unemployed persons with and without children. There is a very sharp distinction between these groups, with a low risk for those without children (more than 100,000 individuals) and a higher risk for those who do have children (some 60,000 cases). About 45 per cent of the unemployed group who have children have a replacement rate above 70 per cent. Close to 13 per cent of the "with children" group of unemployed face replacement rates of more than 90 per cent, compared to just over 1 per cent of the unemployed without children.

TABLE 3 Unemployed Recipients of Jobseekers Benefit/Assistance With and Without Children, Ireland 2015

Replacement Rate Category	With Children	Without Children
	%	%
>70	39.2	6.2
>80	24.2	3.3
>90	12.8	1.4
>100	6.6	0.6
Estimated sub-population:	59,700	103,400

Source: SWITCH.

It is important to consider here the composition of the "with children" group, and the jobseeker's payments they receive. As well as receiving an Increase for Qualified Child (IQC) payment in respect of the dependent child, a significant proportion also receive an additional payment in respect of a dependent adult (IQA).[13] The out-of-work income for those with children is therefore likely to be higher than that of those without children. Compounding this, not only do the "without" children group, by definition, not receive an IQC with their jobseeker's payment, the majority of this group are young single individuals. They therefore would not receive an IQA with their jobseekers payment, and their "out-of-work" income may be further reduced by the reduced jobseeker's payments for those aged under 26.

Savage et al. (2014) reported a significantly higher proportion of high replacement rates than presented here, particularly among the unemployed jobseekers with children. Following extensive development of the SWITCH model to include the new Housing Assistance Payment (see next section), the modelling

[13] Single individuals with children are more likely to receive the One Parent Family Payment (OPF). The OPF has a higher income disregard and a lower withdrawal rate than Jobseeker's Allowance. Recipients of OPF are therefore not included in the unemployed jobseekers group. Work incentives for lone parents are examined in more detail in Savage et al. (2015).

of Rent Supplement in SWITCH was improved. This refinement resulted in a significant fall in the numbers of unemployed facing high replacement rates, while recipients of the Rent Supplement are now less likely to face high replacement rates than previously thought. In addition, new weights to make the SILC 2010 sample representative of the 2015 population have been estimated and used in this analysis. These combined factors result in revised estimates of replacement rates, with a reduced incidence of very high replacement rates among the unemployed jobseekers reported here.

4. RECENT POLICY INITIATIVES

In recent years, a number of new policy initiatives have been introduced with the aim of providing support to individuals or families in Ireland. In this section, we examine the effect of two of these recent policy initiatives on the financial incentives to work for those targeted. First, the Back to Work Family Dividend was designed with the explicit aim of improving the financial work incentives of families in Ireland. The second policy initiative we examine in this section, the Housing Assistance Payment, has wider social goals, but has also been designed in part to improve the financial work incentives of recipients.

4.1 Back to Work Family Dividend

Sections 3 and 4 showed that a higher proportion of unemployed jobseekers with children face high replacement rates than those without children. The Back to Work Family Dividend (BTWFD) announced in Budget 2015 and introduced in mid-2015 aims to improve the work incentives of this subgroup of the population. The Back to Work Family Dividend allows unemployed jobseekers with children, as well as lone parents, to keep the equivalent of any Increases for Qualified Children (€29.80 per qualified child per week[14]) that were being paid with Jobseeker or One-Parent Family Payments for up to a year in employment. Half that amount can be paid in the second year of employment. In this section, we examine the impact of this scheme on the distribution of replacement rates for the unemployed for the first year of employment.

To be eligible for BTWFD, claimants must have been in receipt of Jobseeker's Allowance or Jobseeker's Benefit for at least 12 months (312 days of unemployment) of which at least six months (156 days of unemployment) must have been in the last year. In SWITCH, we use information on duration of unemployment to proxy duration of receipt of JA/JB. Recipients of BTWFD cannot

[14] For unemployed jobseekers that receive a half-rate Increase for Qualified Child (IQC) payment, BTWFD pays the full IQC for the first year of employment.

receive any other social welfare payment, such as partial Jobseekers payments, when taking up employment.[15] In addition, any spouse or partner cannot claim any social welfare payment (other than those listed) when in receipt of BTWFD.

Table 4 shows how the distribution of replacement rates for unemployed jobseekers with children changes when we include the BTWFD in the analysis. The figures shown here represent the first year of employment, as the rate of BTWFD is halved in the second year of employment. The BTWFD significantly improves the financial incentive to work for currently unemployed jobseekers with children. The proportion of this group with a high replacement rate falls from 39 per cent to 32 per cent. Similarly, the proportion with a very high replacement rate falls from 13 per cent to 9 per cent.

The positive effect on the financial incentive to work diminishes in the second year of employment when rates of BTWFD are halved. From the third year of employment onwards, BTWFD ceases to be paid so longer term replacement rates revert to those represented by the "2015 no BTWFD" column.

TABLE 4 Impact of the BTWFD on Replacement Rates of Unemployed Recipients of Jobseeker's Benefit /Assistance with Children - First Year in Employment

Replacement Rate Category	Unemployed on JA/JB with Children	
	2015 no BTWFD	2015 with BTWFD
>70	39.2	31.6
>80	24.2	16.5
>90	12.8	8.7
>100	6.6	4.8

Source: SWITCH.

4.2 Housing Assistance Payment

Housing support payments, such as the Rent Supplement in Ireland or the Housing Benefit in the UK, are designed to provide financial support to low income individuals or households who have difficulty meeting their housing costs. Rent Supplement is the main financial housing support available to low-income tenants in the private rented sector in the Republic of Ireland. The amount of Rent Supplement paid depends on a number of factors, including household income and the rent paid for the property. Maximum rent limits apply, which vary by region and by household composition. If rent exceeds these limits, Rent Supplement is only payable in exceptional circumstances. Crucially from a work

[15] Exceptions to this are Family Income Supplement and Child Benefit, as well as the Medical Card and Rent Supplement which can all be claimed in combination with BTWFD.

incentives viewpoint, claimants can, in general, work no more than 29 hours per week to be eligible for the Rent Supplement.

In March 2012, the government decided to transfer responsibility for the provision of long-term rental housing support from the Department of Social Protection (DSP) to the Department of the Environment, Community and Local Government (DECLG). As part of this transfer, a new Housing Assistance Payment (HAP) was created. HAP, which is primarily a Housing support, unlike Rent Supplement, which is considered an income support, is available to households with a long-term housing need who qualify for social housing support. The HAP programme is currently being piloted in a number of local authority areas.

One key feature is that, rather than having an hours-of-work eligibility cut-off, the costs of HAP are likely to be controlled using maximum rent limits (as per the Rent Supplement). Eligibility for HAP is based on housing need; HAP recipients will make a contribution towards their rent based on their household income, the value of which will be determined by a system of differential rents.[16]

Removal of the hours criterion will mean that recipients remain eligible for HAP in full-time employment. This could result in significant improvements in financial work incentives for some unemployed jobseekers transferring from Rent Supplement to HAP. In other cases, however, replacement rates may change rather little. Work is ongoing in analysing the SILC data using the SWITCH model to examine the balance between these two types of case empirically. The number of recipients of Rent Supplement found in SILC 2010 severely limits analysis of the effect of HAP on work incentives: we are currently exploring approaches which may help to overcome these difficulties.

5. MEDICAL CARDS AND WORK INCENTIVES

The analysis to this point has been based predominantly on cash incomes and benefits. The potential of losing non-cash benefits, such as the Medical Card or GP Visit Card[17] in Ireland, upon taking up employment, can also significantly affect the financial incentive to work. In this section, we discuss some of the issues involved with including the Medical Card and GP Visit Card in this analysis,

16 Differential rent schemes vary across local authorities, but a new differential rents framework that will result in a significant harmonisation of local authority differential rent levels nationally, while retaining some discretion for individual authorities in setting rents in their areas, is currently being finalised.

17 A Medical Card entitles holders to a range of free or almost free medical services such as visits to a GP, nights in hospital, and prescription medication. A GP Visit Card entitles holders to free GP visits only.

and examine how the distribution of replacement rates changes when we include the non-cash benefit in the results.

Almost two million people, or 43 per cent of the population, were covered by a Medical Card or GP Visit Card in 2013. In the same year, expenditure on the General Medical Services (GMS) scheme stood at €1,900 million. The onset of the recession has seen the number of people covered by either a Medical Card or a GP Visit Card increase by 46 per cent since 2007. The scheme, therefore, is of large importance, particularly for those on lower incomes due to its means-tested nature. Previous research has pointed to the importance of the Medical Card scheme with regard to the security it provides to card-holders (Russell and Corcoran, 2000), particularly in light of the unpredictable nature of the usage of health services.

The Medical Card can be expected to affect financial incentives to work because of its means-tested nature. An individual moving from unemployment to employment may find that their employment income raises them above the income threshold for a Medical or GP Visit Card, so that a gain in cash income may be reduced or offset by a reduction in the non-cash benefit afforded by the card. In this section, we examine the impact of Medical Cards and GP Visit Cards on the financial incentives to work in Ireland. The "Medical Card Retention Scheme" means that those who return to work from long-term (more than one year) unemployment may qualify for retention of an existing Medical Card, even though they would not qualify on the basis of their in-work income. Our analysis does not include this scheme, and can therefore be seen as an upper bound on the impact of loss of Medical Cards on replacement rates, given other assumptions.

5.1 Using SILC to Model Medical Card Eligibility

Eligibility for the Medical and GP Visit Card schemes is primarily income-based. Assessment is based on the combined income of the applicant and their spouse. Applicants whose assessable income is in excess of the relevant income limit but for whom the HSE determines refusal of a Medical Card would cause 'undue hardship' can also be awarded a 'discretionary' Medical Card. The HSE estimates that in 2013, 3 per cent of Medical Cards and 21 per cent of GP Visit Cards were 'discretionary' (HSE, 2014).

Using the detailed income information contained in SILC, SWITCH calculates the 'assessable income'[18] of potential Medical Card and GP Visit Card applicants.

[18] Income tax, PRSI and USC are deducted from gross earnings in determining assessable income in the Medical Card means test. Other applicable allowances such as housing costs, childcare costs are also deducted.

Once assessable income has been calculated (allowing for other applicable allowances such as housing costs and childcare costs), this income is compared to the relevant income limit for the person's age, family status (with/without children) and living situation (living alone or with family). Entitlement to a Medical Card or GP Visit Card is then determined based on these income limits.

As the process for evaluating if someone over the relevant income limit would receive a card based on 'undue hardship' grounds is not tightly governed by precise quantifiable rules, we cannot model entitlement to cards on this basis. This would require full information on medical conditions and medical expenses which are not available in the survey. However, given that receipt of a discretionary card by definition is not related to income, they are unlikely to be withdrawn when moving from unemployment to employment. Discretionary cards are unlikely, therefore, to affect significantly the results in this section.

5.2 What is the Value of a Medical Card to an Individual?[19]

As argued by Smeeding (1982), the valuation of medical benefits is particularly difficult, as the value to the recipient is not defined clearly in monetary terms. One valuation approach is to simply divide the total cost of providing the health services by the number of Medical Card holders.[20] In examining the effect of medical and GP Visit Cards on incentives to work, however, taking some account of usage of services is desirable. For example, those who make most use of the card are more likely to be negatively affected financially upon withdrawal of the card, and so may face weaker financial incentives to take up employment which would result in their loss of their Medical Card. The "risk-related insurance" approach is one which takes account of usage of health services. This approach assumes that each individual receives a benefit from the State based on the average spending on his/her age-sex group, irrespective of what use was actually made of public health services. This method has been used internationally by Saunders et al. (1991), Donaldson et al. (2002) and Garfinkel et al. (2004), and in an Irish context by Nolan and Russell (2001).

Based on information from SILC and the Primary Care Reimbursement Service (PCRS) (2013), we can estimate the average cost of the various components of the Medical Card and GP Visit Card services for five different age groups. Three of the predominant health expenditures covered by the Medical Card are nights spent in hospital, costs of medicines, and GP visits. Table 5 reports the value of each of the three components of the Medical Card for five separate age groups. Based on information in SILC 2010, on average, 0 to 4-year-olds spend 0.25 nights in hospital per year, while people over the age of 65 spend 1.2 nights per year in

19 A forthcoming ESRI Working Paper (Keane et al. 2015) will examine the valuation of Medical Cards in more detail.

20 This valuation method is known as the "cost-per-capita" approach.

hospital. As the cost of a night in a public hospital for a public patient is €75, we can simply multiply the average number of nights spent in hospital for each age group by the cost of a night in hospital to find the value of the Medical Card for this component.

A similar approach is used to value the other services offered by Medical Cards and GP Visit Cards. According to PCRS (2013), the annual average cost of medicines on the GMS scheme in 2013 was €660 per year, while an average of €30 per non-Medical Card holder was spent on medicines via the Drug Payments Scheme (DPS). Therefore, the additional value of holding a Medical Card in relation to medicine costs was, on average, €630 per year. Again, older individuals are most likely to purchase medicines. Expenditure on medicines for those over 65 was more than double the average expenditure at €1,470 per year, or €28 per week. For those aged between five and 14, the average cost of medicine was just above €2 per week.

Finally, based on the total payments to GPs through the GMS scheme of €448 million in 2013 (PCRS, 2013), the average expenditure per Medical Card and GP Visit Card holder on GP visits was €227 per year. The final column of Table 5 shows that the cost of provision of GMS again varies by age group, with expenditure on those aged over 65 highest at €6 per week. The value of a Medical Card or GP Visit Card in this analysis therefore varies according to the age composition of the recipients. For example, a GP Visit Card for a 35-year-old single individual would cost €170 per year to provide, or €3.25 per week. A Medical Card for a 35-year-old couple with two children aged under five would cost €1,565 per year to provide, or €30 per week.

TABLE 5 Valuing the Medical Card and GP Visit Card by Age Group - € per week, 2015

Age Group	Nights in Hospital	Cost of Medicines	Cost of General Medical Services
0 to 4	€0.36	€2.05	€3.25
5 to 14	€0.43	€1.69	€2.67
15 to 44	€0.66	€5.44	€3.25
45 to 64	€1.42	€16.07	€4.06
65+	€1.73	€28.15	€6.00

Source: SILC (2010) and PCRS (2013)

Note: Percentage of average cost of GMS services in each age group assumed to be the same as percentage of average expenditure on drug payments in each age group.

While the valuation approach used here assigns a higher value of holding a Medical Card to age groups that make most use of the medical services, variation

within each age group in the use of Medical Card services is omitted. Valuation methods based on actual usage of medical services would assign a higher value to recipients who frequently use the medical services, most likely those in ill-health. Conversely, those who use health services least would be assigned a lower value of holding a Medical or GP Visit Card. The overall impact on the distribution of replacement rates of an alternative valuation approach is therefore ambiguous. Future work will examine sensitivity of these results to different valuation methods.

5.3 Medical Cards and Replacement Rates

Using the values of Medical Cards and GP Visit Cards presented in the previous section, we can examine the effect of including these health-related benefits in the replacement rate calculation on work incentives in Ireland. Table 6 shows the distribution of replacement rates for unemployed recipients of Jobseeker's Allowance or Jobseeker's Benefit when the value of the Medical Card or GP Visit Card is not included (second column) and when the value of the cards are included (third column). Given the means-tested nature of the Medical and GP Visit Cards, it is unsurprising to see a higher proportion of individuals facing high or very high replacement rates when we include the value of the cards. However, the changes due to the inclusion of Medical and GP cards are relatively small. The proportion of unemployed jobseeker's facing a replacement rate of 70 per cent or higher, for example, increases by 2 percentage points, while the proportion facing the highest replacements rates (greater than 90 per cent) increases by 1 percentage point.

TABLE 6 Impact of the Medical Cards on Replacement Rates of Unemployed Recipients of Jobseeker's Benefit /Assistance

RR Category	2015	2015 with Medical Card or GP Visit Card
>70	18.3	20.2
>80	11.0	12.5
>90	5.6	6.6
>100	2.8	3.1

Source: SWITCH.

Table 7 provides more detail on the effect of Medical and GP Visit Cards on the replacement rates of unemployed jobseekers. The replacement rates of almost 90 per cent of the unemployed increase due to the inclusion of Medical and GP Visit Cards in the analysis. However, the vast majority of these increases are small. Of those with a replacement rate greater than 70 per cent before the inclusion of the Medical Card, two out of three experience an increase in their replacement rate of less than 2 percentage points due to the inclusion of the card. Overall, just above one in eight unemployed jobseekers see their

replacement rate rise by more than 5 per cent due to the inclusion of Medical and GP Visit Cards.

TABLE 7 Change in Replacement Rates Due to Impact of the Medical Cards - Unemployed Recipients of Jobseeker's Benefit /Assistance

Initial Replacement Rate	Change in Replacement Rate		
	≤ 2	2 to 5	5+
	%	%	%
≤70	49	41	10
>70	66	13	21

Source: SWITCH.

Why do we not observe a bigger impact on replacement rates when we include the value of Medical Cards? Two main reasons can be identified. First, the composition of unemployed jobseekers is heavily tilted towards young single individuals. According to the Department of Social Protection (2013), in 2013 almost 80 per cent of recipients of Jobseeker's Allowance or Jobseeker's Benefit were aged less than 45. Similarly, NESC (2011) showed that 60 per cent of recipients of a jobseekers' payment were single claimants. This is reflected in the composition of unemployed jobseekers in SWITCH, where over 70 per cent of unemployed jobseekers are under 45, the majority of whom do not have children. Therefore, the majority of those under analysis receive a relatively low value for a Medical or GP Visit Card when out of work.[21]

Even for unemployed jobseekers with children, the effect of the Medical Card on work incentives is quite limited. The replacement rates of unemployed jobseekers with children increase by more than those without children as a result of including the Medical and GP Visit Cards, as shown in Table 8. Again however, the differences are only minor. The proportion of unemployed jobseekers with children facing high replacement rates (greater than 70 per cent, greater than 80 per cent) increases by between 2 and 4 percentage points, while the proportion of those with children facing the highest replacement rates increases by 1 percentage point. For unemployed jobseekers without children, the effect of the Medical Card is even less pronounced, with the proportion facing the highest replacement rates remaining unchanged.

[21] As estimated wages attach a premium to age and being married, younger single individuals may also be less likely to lose the medical or GP Visit Card in employment. However, married couples have a higher income limit in the Medical Card and GP Visit Card means test, so that the overall effect is ambiguous. This issue requires further investigation.

TABLE 8 Impact of the Medical Cards or GP Visit Cards on Replacement Rates of Unemployed Recipients of Jobseeker's Benefit /Assistance – With and Without Children

Replacement Rate Category	With Children		Without Children	
	2015	2015 with Medical Card and GP Visit Card	2015	2015 with Medical Card and GP Visit Card
>70	39.2	43.6	6.2	6.6
>80	24.2	27.4	3.3	3.9
>90	12.8	13.5	1.4	2.6
>100	6.6	7.5	0.6	0.6

Source: SWITCH.

The second reason is that the nature of the Medical Card means-test and the introduction of the GP Visit Card means that over a quarter of those in receipt of a Medical Card or GP Visit Card when unemployed would also be in receipt of one of the cards in employment. A married individual with two children, for example, can have assessable income above €500 per week and still receive a GP Visit Card. In these cases, the in-work income is also increased by the inclusion of Medical Cards and GP Visit Cards in the analysis, so that the increase in their replacement rate is not as large as it would have been if the cards were fully withdrawn in employment.

The valuation of the Medical and GP Visit Cards used in the analysis may also contribute to the lack of sensitivity in the replacement rate results. While the valuation varies by age group to reflect average usage, there will be considerable variation within each of the age groups on how much usage is actually made of the health services covered by the Medical and GP Cards, as well as variation in the self-perceived value of the cards. Alternative valuation approaches may therefore produce higher estimates of replacement rates for certain subgroups of the unemployed population, such as those in ill-health or with family members with chronic illness. Of course, these alternative valuation approaches would correspondingly produce lower estimates of the replacement rates for groups who rarely use the medical services.

5.4 GP Visit Cards for Children Under the Age of Six

From mid-2015, all children under six years of age will be entitled to free GP care. In this section we examine the impact of this policy on the work incentives of unemployed recipients of jobseekers payments.

The value of the free GP Visit Card to children under six is shown in Table 5. The average expenditure on GP visits is €227 per year. Average expenditure on this service for the under-five age group is 17 per cent of the national average.

Therefore, for each child under six in a family, the value of a free GP Visit Card can be approximated as a €38.60 increase in income per year, or 75c per week.

Of course, the free GP Visit Card for under six-year-olds only results in an increase in income for families who do not otherwise qualify for a Medical Card or GP Visit Card. Of the approximately 25,000 unemployed jobseekers whose child qualifies for the free GP Visit Card, more than half would already be eligible for a Medical Card or GP Visit Card when in full-time employment, based on the estimated wages discussed in Section 2. It is unemployed jobseekers with relatively high earning potential that are most likely to gain from this policy.

Given the relatively low number of unemployed jobseekers that stand to gain from the policy, and the relatively low valuation of a GP Visit Card for children under six in this analysis, it is unsurprising to find that the distribution of replacement rates remains unchanged from those presented in Table 6 following the introduction of free GP Visit Cards to children under the age of six. Again, a different valuation approach may result in a larger impact on replacement rates. For example, families whose child uses GP services regularly may place a higher valuation on the free GP care for children under six.

6. CONCLUSIONS

This paper examined the financial incentives to work implicit in the Irish tax and benefit system by estimating replacement rates for a representative sample of the population. We found that almost four out of five unemployed jobseekers would see their income increase by at least 40 per cent upon taking up employment. For those individuals who would be financially better off not in work than in work, close to five out of six still chose to work. Dynamic factors, such as working on a low wage now in expectation of future wage increases, at least partly explain the decision to work in this scenario. While the vast majority of unemployed jobseekers have strong incentives to work, certain subgroups of the population are at higher risk of facing weaker incentives to work. Specifically, unemployed jobseekers with children, a group that makes up just one-third of the unemployed population, have a relatively high risk of facing weak incentives to work. Even among this group, however, only one in 15 would be financially better off not working.

The Back to Work Family Dividend scheme improves the work incentives of unemployed jobseekers with children, in the short term at least. The scheme, announced in Budget 2015, allows unemployed jobseekers with children, as well as lone parents, to keep the equivalent of any Increases for Qualified Children (formerly termed Child Dependant Additions) that were being paid with

Jobseeker or One-Parent Family Payments for up to a year in employment. Half that amount can be paid in the second year of employment. In the first year in employment, the proportion of unemployed jobseekers with children facing a high replacement rate (over 70 per cent) fell from 39 per cent to 32 per cent. Similarly, the proportion who would be financially better off not working than working decreases from 1 in 15 to 1 in 20.

These results, and earlier research, have been based on cash incomes and benefits. However, the potential loss of a non-cash benefit, in the form of a Medical Card is often seen as a potential barrier to taking up employment. This paper extends earlier work by attributing a value to a Medical Card, based on average usage for adults and children of different ages. We do not take account of the scheme under which long-term unemployed can retain a Medical Card for up to three years. As a result, our findings can be seen as an upper bound on the impact of Medical Cards, given other assumptions. Applying this approach, we find that the loss of the Medical or GP Visit Card upon taking up employment does decrease slightly the financial work incentives for most jobseekers. However, the overall distribution of replacement rates for unemployed jobseekers remains largely unchanged following the inclusion of a value for a Medical Card in the analysis. For individual cases where families make above average use of a Medical Card, or are highly risk averse, somewhat greater impacts could be expected. As against this, the retention of Medical Cards would tend to reduce the impact.

Future work on financial incentives to work will compare the incentives implicit in the Irish tax and benefit system with those of the UK system. This work will help provide evidence on how the work incentives faced by the unemployed jobseekers in Ireland compare internationally.

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