IFA Submission to Government on National Pensions Policy

Introduction

IFA welcomes the decision by the Government to undertake a major review of national pensions policy, which commenced with the Pensions Board report published in October 2005, to be followed by a Green Paper, and final decisions in a White Paper.

IFA made a submission in February 2007 in advance of the Green Paper. IFA takes this opportunity to review our earlier submission in the context of issues raised in the Green Paper. Overall, IFA's view of the Green paper is that it is a disappointing document, which did not progress the debate very much from the options set out in the 2005 Pensions Board Report. IFA proposes that, following the end of the consultation period in mid-2008, the White Paper on Pensions should be published before the end of this year.

IFA notes that the Pensions Board report considered that the main targets set out in the earlier NPPI report on pensions strategy remained valid. The Board recommended an overall retirement income target of 50% of pre-retirement income, a Social Welfare pension of 34% of gross average industrial earnings, and a supplementary pension coverage rate of 70% of those aged 30 and over. In broad terms, IFA supports these targets.

IFA proposes that the thrust of the new national pensions policy should be to:

- Ensure that the coverage of state (PRSI) pensions is as comprehensive as possible, for all persons in the workforce.
- Increase the supplementary pension coverage rate by means of incentivised voluntary private pensions coverage.
- Achieve a pensions policy outcome that is affordable to both the economy and the individual, bearing in mind certain fundamental realities, particularly the implications of population ageing, and the impact of competitive pressures on the Irish economy linked to its relative openness.

IFA's submission takes into account certain relevant characteristics of the farming sector – average farm income is at best no more than two-thirds of average industrial earnings, and the average age of farmers is higher than for the workforce in general.

In addition, the submission takes into account the reality that self-employed persons including farmers have to meet the full cost themselves of private pension contributions, unlike many employees who can share the cost with employers.

IFA PROPOSALS

IFA's proposals are set out under the following headings: State Contributory (PRSI) Pensions; Other State Pension Issues; Second Tier Pensions.

A.State Contributory (PRSI) Pensions

1.The Level of PRSI Pensions
The current policy of Government is that PRSI pensions should equate to about 34% of average industrial earnings (AIE), and this target has been broadly achieved in 2007. The main case for not increasing the state pension to a higher % of AIE relates to the population ageing factor. The Green Paper report states that in 2006 there were 5.6 people of working age for each person aged over 65; this ratio will change to 1.8 by 2061. The implication is that the ageing factor alone will require higher PRSI contribution rates over time.

Secondly, from the perspective of farm families, on the basis that (a) average farm income is significantly lower than average industrial earnings, and (b) assuming in most cases in the future that both spouses have a state pension, a pension of 34% of AIE would provide a reasonable income replacement rate for farmers in the "average" situation (see examples in Appendix).

Thus IFA proposes that the 34% of AIE level for state pensions is an appropriate target for the future. This proposal clearly implies that state pensions should increase in line with the % increase in average industrial earnings in the future.

2.The Contribution Rate/Future Sustainability
A decision by Government to hold PRSI pensions at 34% of AIE is unlikely in itself to avoid future sustainability problems.

A further increase in the retirement age is an obvious option to be considered by the Government (as has happened in the UK and other countries). If this option is chosen, a long period of advance notice should apply, e.g. exclusion of persons aged over 50 in 2008 from any increase in retirement age.

Second, if future increases in contribution rates are necessary to ensure sustainability of the system, there should be a considerable time gap (e.g. 10 years) between their advance announcement and their implementation. This approach based on "advance announcement" should broadly reflect the changes in longevity and thereby be reasonably equitable across generations.

Whatever options are chosen in the future, the PRSI contribution rate for pensions coverage should not discriminate against sectors of the economy which have a relatively unfavourable (i.e. older) age structure, or where incomes are lower than the national average.

3. PRSI Coverage for Excluded Groups – Priority Groups in the Case of Farm Families

1. **Farmers**
   The following problems have been identified by IFA:
   - Low Income Farmers: those whose tax returns show that they have "no net liability" or "NNL" for income tax, but are liable to pay a flat-rate PRSI to the DSFA if their income is above €3,174. Some have failed to do this. IFA

proposes that a time limited amnesty should be provided whereby retrospective contributions could be made.

  - Farmers in the Farm Assist Scheme: These farmers had been excluded from compulsory PRSI coverage although their incomes could be well above the €3,174 threshold. IFA raised this anomaly in our 2007 pre-budget submission. Compulsory coverage applies from 2007, but the gaps in their PRSI records may be a problem. IFA proposes that, where problems arise due to the exclusion, these farmers should be allowed to make retrospective contributions to provide at least a 98% pension.
  - Farmers in the EU Early Retirement scheme who failed to maintain their PRSI record by voluntary contributions. IFA proposes that these should be provided the opportunity to make retrospective contributions.

2. **Self-employed Spouses**

   IFA has discussed in detail with the DSFA the problem of lack of PRSI coverage for certain spouses (usually wives) at work on farms. Negotiations have been successfully concluded with the Department of Social Protection, and Revenue, in January 2008 on two key issues. First, the criteria used by the DSFA and Revenue in determining the existence of a partnership have been clarified and documented for the first time. Second, spouses who were effectively working in partnership in previous years, but who did not claim so when making their annual tax returns, will have the opportunity to claim for a spouses partnership status retrospectively. IFA has welcomed these reforms.

   IFA considers that there will be a need for ongoing dialogue with the Department of Social Protection on the implementation of the agreement that certain spouses' partnership can be recognised retrospectively.

   A further problem for such spouses is the "averaging rule" used in the determination of the level of pension entitlements. This is covered in the following section.

B. Other State Pension Issues

1. The "Averaging Rule"

1. **Spouses – Homemakers' Disregard**
   For spouses who had PRSI coverage in their early career prior to becoming a homemaker, and who are now disadvantaged by the "averaging rule", an earlier threshold than 1994 for the Homemakers Disregard scheme should apply; IFA proposes that Homemakers Disregard should apply from the first date of payment of child benefit. Also, PRSI "disregards" should be progressively transformed to credits.

2. **Exclusion of Short Contribution Periods**
   The "average contribution test" is also particularly penal on people who had very short periods of employment in their early working life. IFA proposes that isolated

periods of employment of up to 1 year in total should be discounted in conducting the average contribution test.

3. **The Question of Replacing the Average Contribution Test by a Total Contribution Test**
   Bearing in mind the piece-meal development of the social insurance system to date, and the exclusion of certain groups, IFA considers that the system is not developed for a sufficiently long period to switch to a "total contributions" test. IFA supports the assessment in the Green Paper on this issue: "Having examined the implications, it may be considered that it would be prudent to postpone a move towards a total contributions approach because of the varying levels of contribution which people qualifying for pension today have on their records. This will improve in future as improved social insurance coverage feeds into the system and brings more consistency into the insurance records of those applying for a pension".

2. Certain Self-Employed Contributors excluded by "10 year" Rule

IFA continues to hold serious concerns at the treatment of a relatively small group of self employed people (who were in the 60-65 age bracket in April 1988) and who do not fulfil the eligibility criteria for the state contributory old age pension.

IFA submits that eligibility for the special 50% state contributory old age pension should be extended to those aged between 60 and 65 years in April 1988. Furthermore, the Special pension rate available to the group aged between 56 and 60 years in April 1988 should be increased from 50% to 75%.

IFA takes this opportunity to remind the Government of the report and recommendations of the Human Rights Commission in April 2007 in relation to State pension eligibility for elderly self-employed people who had made compulsory PRSI contributions but were denied pensions.

The Commission recommended that such persons who have been denied pensions only because of their age bracket should be granted reduced pensions. IFA is concerned that the Government has, to date, ignored the recommendation of the Human Rights Commission.

3. Earnings Disregard for State Non-Contributory Pension

The new State Pension (non-contributory) came into effect on 29 September 2006, replacing the previous old-age non-contributory pension. Also, for people aged 66 or over, the State Pension (non-contributory) replaced the widow/er's non-contributory pension, blind pension, one-parent family, deserted wife's allowance and prisoner's wife's allowance. This is a means tested pension and in 2006 claimants were granted an employment earnings disregard of €100/week (or €5,200 per annum) in assessing their eligibility for this pension. This was increased to €200/week in the 2007 budget. However, income from self-employment or farming does not quality for this disregard. In IFA's view, there is no justification as to why one form of earned income (up to €200/week) is disregarded while another form of earned income is not.

IFA proposes that the eligibility criteria for the State non-contributory pension should permit the earning of an equivalent amount of farm income to that applied to employment income.

C. Second Tier Pensions

The Pensions Board report outlined a number of options for supplementary pensions coverage including second tier pensions. In broad terms, the options are as follows:

- A significant increase in the current flat-rate state pension (e.g. towards 50% of AIE),
- Earnings related state pension based on compulsory earnings-related contributions,
- A mandatory private pension (e.g. to bring one's total pension up to level of at least 50% of AIE),
- Incentivised voluntary private pension provision – this is the current system.

Taking into account the examples set out in the Appendix on income replacement based on PRSI pensions set at 34% of AIE, and other relevant factors such as affordability, IFA proposes that second tier pensions in the future should continue to be based on the "incentivised voluntary private pension provision" policy. However, the level of incentive should be improved for persons on relatively low incomes as follows:

- Income tax relief on contributions to personal pension plans should be equalised by increasing the tax relief available to standard rate taxpayers to the top rate of income tax. This would be achieved by a pensions tax credit.
- Persons at work including farmers who do not have a taxable income in a particular tax year should be encouraged to make and continue pension contributions by the addition of a 40% exchequer top-up on their contributions to an approved pension plan (including a PRSA), similar to the SSIA scheme.

These two proposals would introduce much greater equity to the current tax-based incentives for private pensions.

APPENDIX

Income Replacement

The problem of no second tier coverage is greatest for those on lowest incomes, and many farmers are in this category. A central question is: what is the minimum acceptable income replacement ratio in retirement, and how far will the PRSI pension go. The following examples are based on 2007 data, but assume that the spouse's IQA has reached to non-contributory pension level.

Background data for 2007

Average industrial earnings	€32,500
Contributory pension (33.5% of AIE)	€10,884
Spouses' IQA	€10,400

Examples:

1. Farm income of €20,000 and employee earnings of spouse of €20,000; total €40,000.
   2 PRSI pensions : €21,768
   = 54.4% of income

2. Farmer and spouse working on the farm, total income €25,000
   1 PRSI pension: €10,884
   1 IQA (full): €10,400
   €21,284
   = 85% of income

3. As (ii) but spouse qualifies for only 50% of IQA
   1 PRSI pension: €10,884
   50% of IQA: €5,200
   €16,084
   = 64.3% of income

4. Farmer and spouse working on farm and operating a "spouses partnership", with a total income of €35,000
   2 PRSI pensions : €21,768
   = 62% of income

5. Single farmer with a farm income of €22,000
   1 PRSI pension: €10,884
   = 49.5% of income