Response of the TASC/Trinity College Dublin Pension Policy Research Group to the Green Paper on Pensions

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Response of the TASC/Trinity College Dublin Pension Policy Research Group to the Green Paper on Pensions[1]

Section 1: A 'glass half full' Perspective on the Future Sustainability of State Pensions

The response of the TASC/Trinity College Dublin (TCD) Pension Policy Research Group is in three parts. Section 1 addresses demographic and sustainability issues, Section 2 considers costs, returns and risks and Section 3 deals with public and private pension provision and policy options for eliminating pensioner poverty. The tables and figures are numbered sequentially within each section.

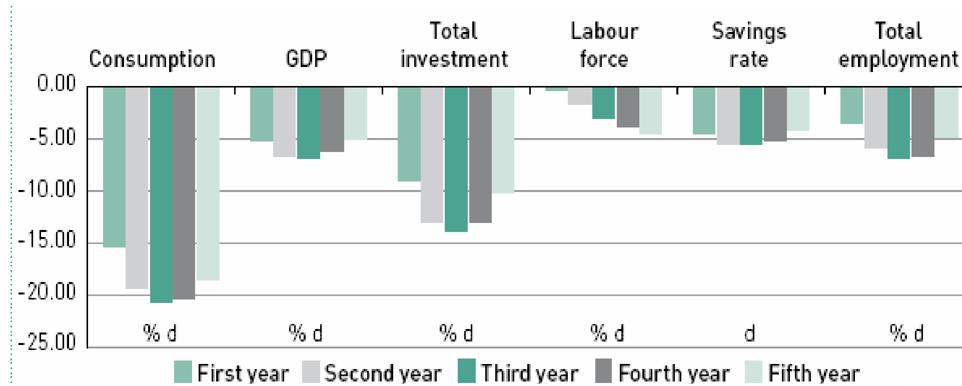
One of the key issues surrounding future pension provision is the sustainability of first tier or State pensions. Issues of sustainability are dealt with in Chapter 3 of the Green Paper which is in turn informed by Mercer's (2007) review of the Social Insurance Fund (SIF) carried out in 2005 and revised in 2007.

In introducing this topic the challenges are laid out clearly, although it could be argued that the Green Paper overall takes a 'glass half empty' rather than a 'glass half full' perspective. Solutions to address issues of future sustainability, for example, at the macroeconomic level, are presented in somewhat apocalyptic terms. Figure 3.4, for example, reproduced below as Figure 1.1, outlines a scenario where the exchequer would be obliged to raise €12bn in additional taxes in one year to meet the increased age related spending with obviously a devastating impact on the economy. The reality, of course, is that we have several decades to plan for increased spending in this area.

Chapter 2 of the Green Paper identifies the demographic challenge that frames the discussion of the future sustainability of pensions in Chapter 3. All commentators agree that the challenge will reflect the projected transition from our current position of experiencing a low level pensioner support ratio (defined as those aged 20 to 64 divided by those aged 65 and over) to one that will be much higher by the middle of the century. However, great uncertainty remains regarding long term projections, particularly in relation to migration which has always been the most unpredictable factor shaping Irish demography. Figure 1.2 shows that different assumptions regarding migration produce different support ratios 40 to 50 years into the future. Most population projections adopt conservative assumptions when going beyond a 20 to 25 year timeframe and both the Mercer and Connell projections underlying Figure 1.2 assume that there will be relatively low levels of net in-migration in the medium to long term. These are consistent with the M1 (low migration) assumption used by the Central Statistics Office (CSO) in generating its latest population projections. On the other hand the 'high migration 1' and 'high

[1] TASC is an independent think tank committed to radical thinking leading to progressive social change in Ireland. The members of the TCD Pension Policy Research Group are Peter Connell, Information Services, Gerard Hughes, School of Business, Anthony McCashin, Department of Social Studies, and Jim Stewart, School of Business.

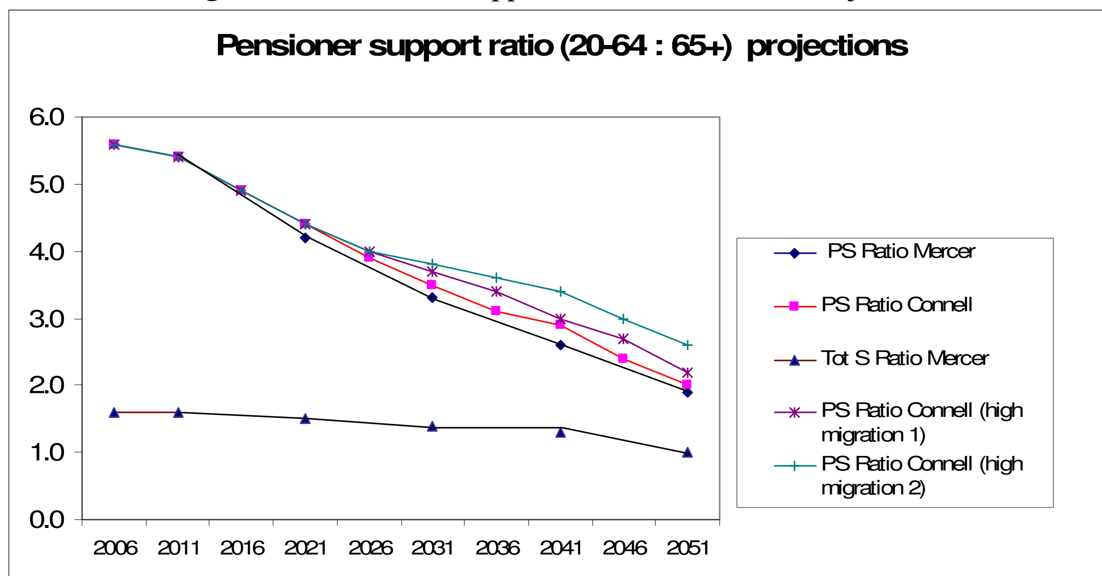
Figure 1.1: Illustrative Macroeconomic Effects of Increasing Taxes to Raise an Extra €12 billion



Source: Figure 3.4, *Green Paper on Pensions (DSFA, 2007: 28)*

migration 2' assumptions, which assume high net in-migration after 2031 produce lower pensioner support ratios. It is worth noting that all the projections suggest that the 'total support ratio', which is the population aged 20 to 64, divided by the sum of the population aged 0 to 19 and 65 and over, does not change dramatically over the period.

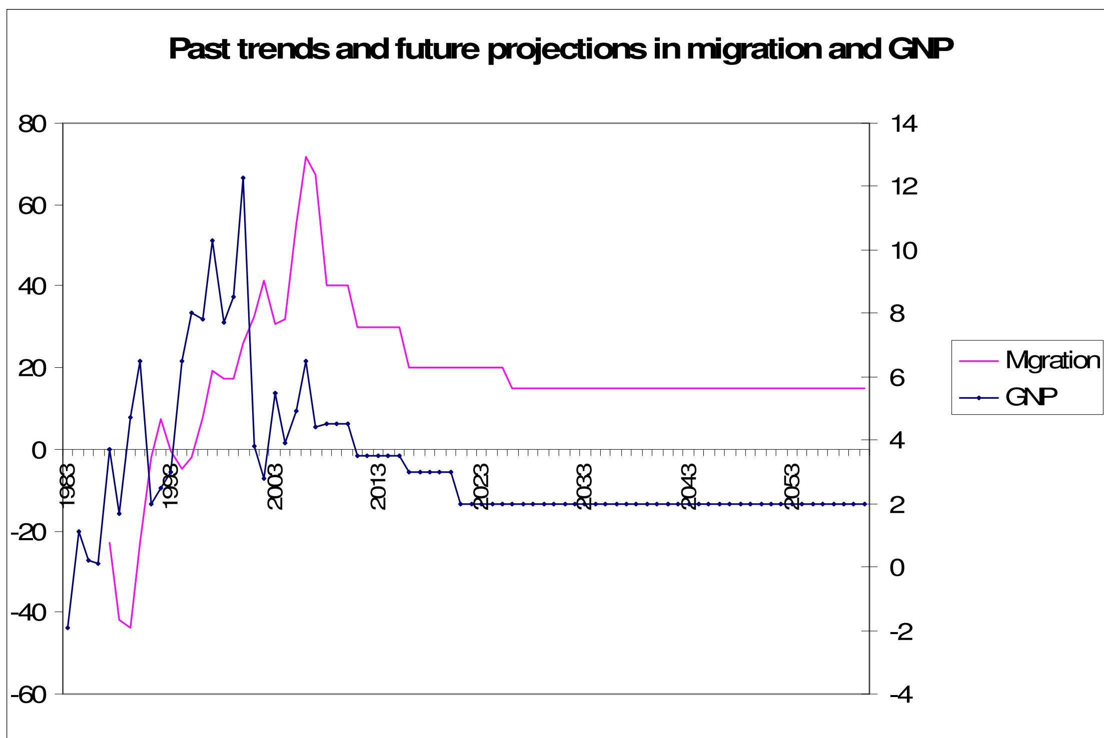
Figure 1.2: Pensioner Support Ratio (20-64: 65+) Projections



Assumptions regarding future trends in migration must take into account a wide range of factors, in particular patterns of economic growth in Ireland and in the EU. High Gross National Product (GNP) growth in Ireland will stimulate demand for labour and generate in-migration while, at the same time, underpin the affordability of State pensions by raising the pensioner support ratio and enhancing the state of the public finances. It is obvious that any attempts to project future trends in GNP growth represent a hazardous

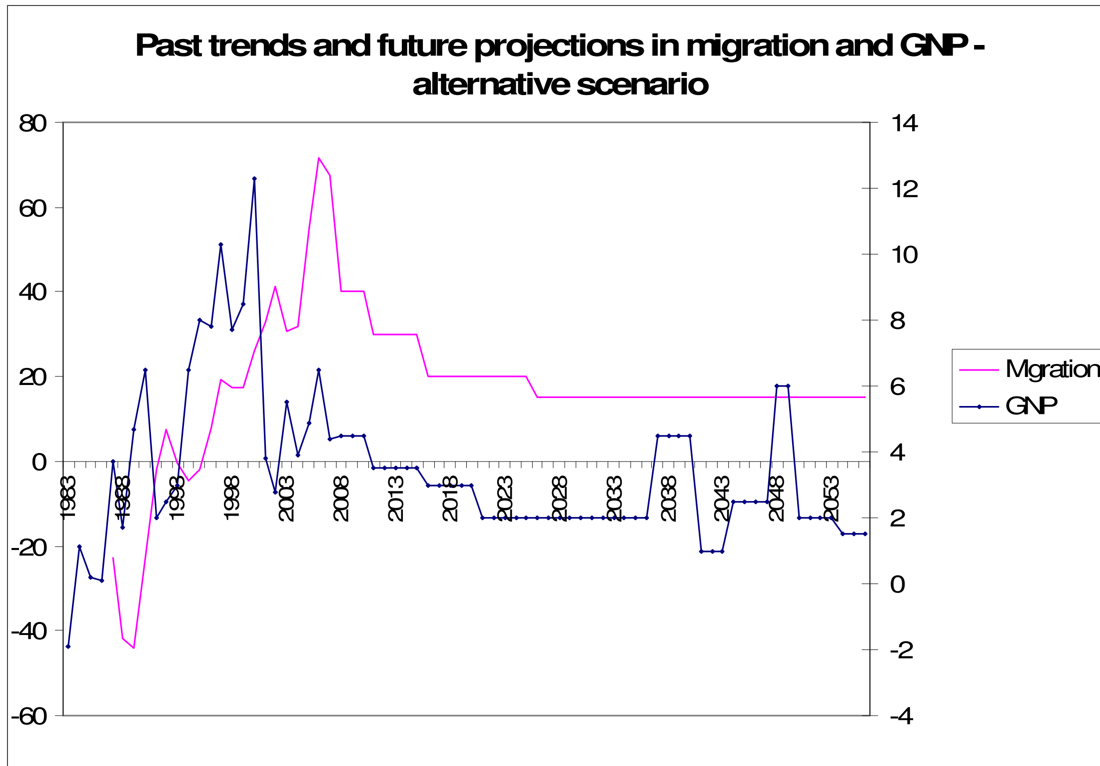
task. However, it is significant that Mercer's Actuarial Review of the SIF, which informs the Green Paper, adopts a very conservative assumption regarding long term growth in the Irish economy, with projected growth of 2 per cent per annum between 2021 and 2056. This assumption is set in the context of trends in the last 25 years in Figure 1.3 which tends to highlight the somewhat pessimistic nature of this assumption. In fact all economic scenarios presented in Appendix D of the Mercer review are more pessimistic than this 2 per cent 'central scenario'.

Figure 1.3: Past Trends and Future Projections in Migration and GNP



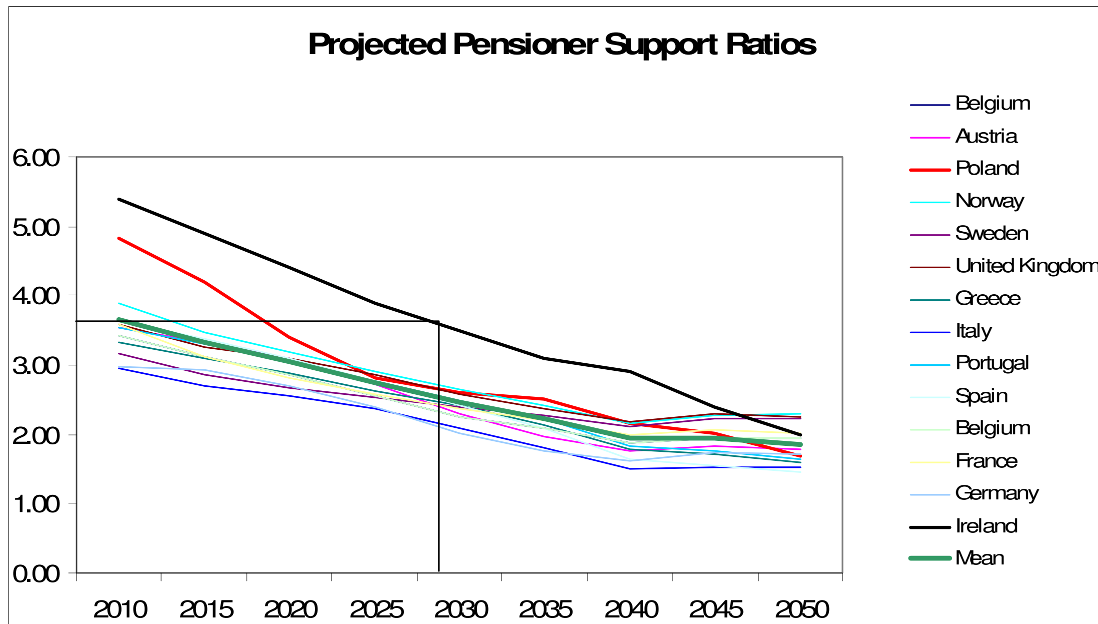
By 2051, however, the cumulative difference in the size of the economy, given alternative assumptions regarding GNP growth, could be quite significant. Growing at 2 per cent per annum in the period 2021-2051 the economy would be 181 per cent larger than at present; growing at 2.4 per cent per annum in 2021-2051 it would be 205 per cent larger. The discussion on the sustainability of future State pensions in the Green Paper focuses on the growing proportion of GNP that will be required to fund the SIF and that the deficit in the SIF will grow to 'unsustainable' levels as a proportion of GNP by the middle of the century. However, quite small changes in our assumption relating to future GNP growth can have a significant effect on the size of the denominator. The scenario presented in Figure 1.4 increases the dominator by 13 per cent, thereby reducing the proportion of GNP required to sustain the pension system. Apart from the fact that this exercise illustrates the potentially significant effect of varying assumptions about future economic growth, it also highlights the essential role of economic growth in underpinning the sustainability of future pensions.

Figure 1.4: Past Trends and Future Projections in Migration and GNP – Alternative Scenario



At several points the Green Paper makes reference to the fact that pension systems in many European countries have undertaken significant reform in the last decade in response to growing crises in sustainability. What the Green Paper gives less prominence to is the fact that most of these systems are much more generous in terms of income to pensioners than the Irish State system and that Ireland's demography is almost unique when it comes to its current high Pensioner Support Ratio (PSR). This is graphically illustrated in Figure 1.5 which shows that only Poland has a PSR close to the Irish level. Furthermore, this positive position will be sustained for the next 30 to 35 years with Ireland having a comparative advantage over all European countries until the 2040s. Ireland's PSR will only reach the current European average in about 25 years time.

Figure 1.5: Projected Pensioner Support Ratios



While it is true that the Irish PSR will fall more quickly than other European countries, this simply reflects the uniquely positive position in which we currently find ourselves. The same argument applies when it comes to looking at overall State expenditure on old age benefits. Figure 1.6 shows that in terms of the proportion of GDP spent on old age benefits, Ireland is in quite an anomalous position, certainly when compared to other western European countries. The Green Paper states that:

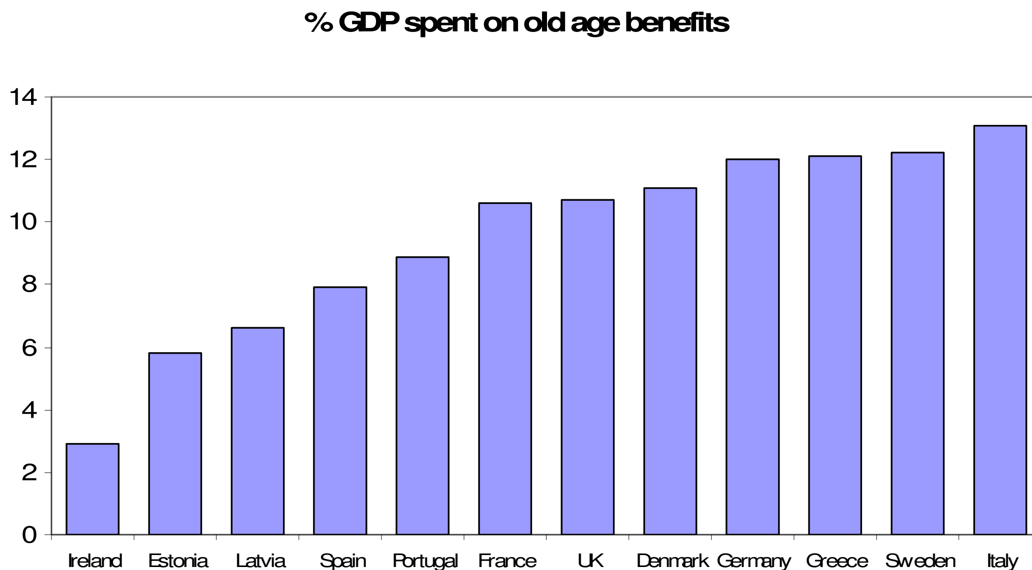
> As in Ireland, rising public pension spending is a concern in many countries. Although Ireland has a longer timeframe than most to prepare for the coming challenge, the increase that we are set to experience over the period to 2050 is roughly three times greater than the European average. (DSFA, 2007: 26)

Again, our starting point is quite different and very much more favourable than most European countries. In Chapter 3 the Green Paper suggests that age related expenditure could reach 13 per cent of Gross Domestic Product (GDP) by 2050. Figure 1.6 shows that it has already reached levels quite close to that in a number of the larger European countries.

The Green Paper outlines a range of policy options aimed at securing the financial and social sustainability of future pensions. These include:

- Raising retirement age
- Increasing share of the population at work
- Increasing exchequer savings
- Easing upward spending pressures
- Improving the economy's productive capacity
- Increase contribution rates

Figure 1.6: Percentage of GDP Spent on Old Age Benefits



Focusing on the first two of these it is apparent that Ireland is again well positioned relative to our European neighbours. As Table 1.1 shows, a number of countries face significant challenges in raising the labour force participation rates for those aged 55 to 64. Countries such as France, Italy, Belgium and Austria have male participation rates that are over 50 per cent lower than Irish rates. The situation regarding female participation rates is somewhat different with Ireland's low rates reflecting the historic legacy of low female participation rates in the 1970s and 1980s. However, the current

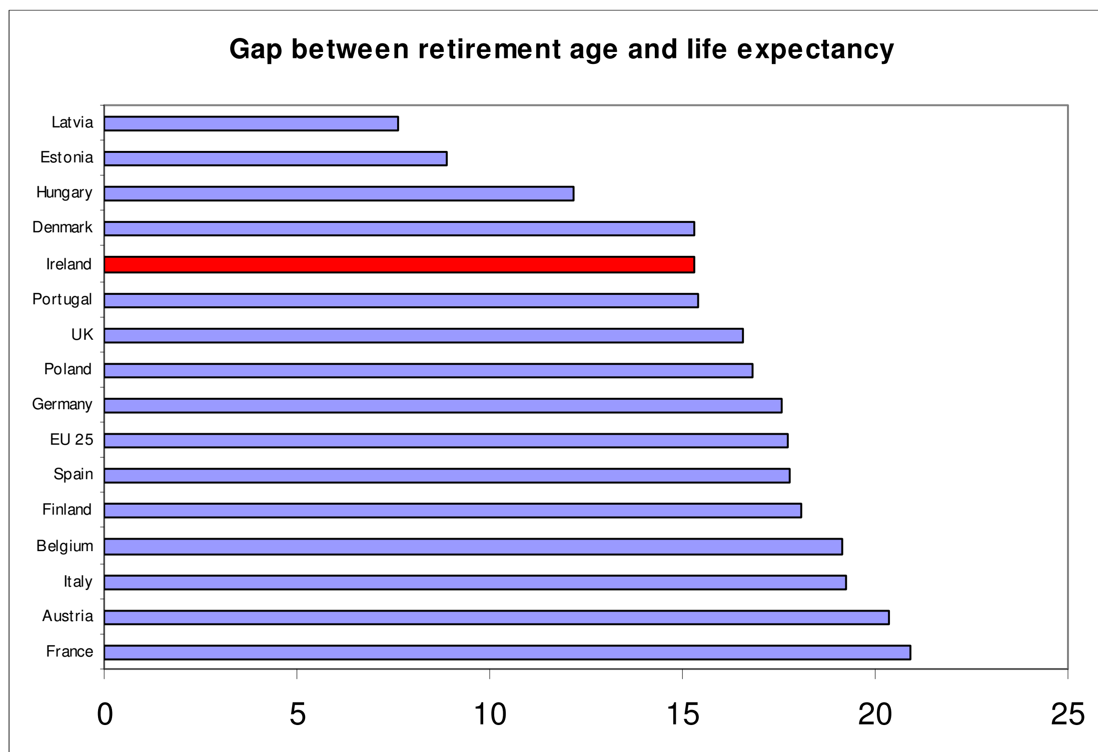
Table 1.1: Labour Force Participation Rates for Those Aged 55-64 in EU Countries

	Males	Females
Austria	39	20
Belgium	38	21
Denmark	67	53
Finland	51	50
France	41	34
Germany	51	33
Greece	56	49
Ireland	65	34
Italy	42	20
Netherlands	57	33
Portugal	59	43
Spain	59	25
Sweden	71	67
United Kingdom	66	47
EU15	52	33
EU25	51	32

low rates are certain to change as the higher participation rates of women in their 20s, 30s and 40s feed through to the older age groups in the future. This is not to ignore the fact that policy initiatives are required to increase the participation rates of married women into the future.

Reflecting these high participation rates is the fact the average Irish exit age from the labour force is 64.1 years compared to an EU25 average of 60.9. Apart from retirement age, the financial sustainability of a pension system is also affected by life expectancy. Increasing life expectancy has been one of the factors affecting the solvency of pension schemes in recent years. A key consideration here is life expectancy at retirement age. Figure 1.7 shows that in Ireland's case the combination of high average retirement age and relatively low life expectancy results in a shorter time span for which pensions must be paid. In this regard Ireland has more in common with emerging economies such as Latvia and Estonia than with our western European neighbours.

Figure 1.7: Gap Between Retirement Age and Life Expectancy



Of course, it is the case that improvements in life expectancy in Ireland have been quite significant in recent years. This is confirmed by recent CSO reports showing that male life expectancy at birth has increased by 5.7 years for males and 4.9 years for females between 1986 and 2005. While much of this improvement reflects increased life expectancy among older adults, Ireland still lags behind most western European countries in this regard and is not closing the gap with the countries with the best life expectancies. Table 1.2 shows that male life expectancy at 65 is 20 per cent shorter and for females 11 per cent shorter than in Switzerland. In the medium term it is likely that Ireland's combination of a higher retirement age and lower life expectancy will continue to confer

on it a comparative advantage when it comes to the financial sustainability of its State pension system.

In assessing the sustainability of the Social Insurance Fund (SIF), the Mercer review suggests that PRSI contribution rates would need to increase by 78 per cent to allow the fund to break even in 50 years time. Scenarios are also presented showing the impact of State subventions to the fund. It is certainly the case that contribution rates are very low when compared to most other western European countries. If we are to meet the challenges that the country's changing demography will pose – the kind of challenges currently being encountered by our neighbours – then it is difficult to resist the argument that we need to increase social contribution rates to something approaching the rates in these countries.

Table 1.2: Life Expectancy at Age 65 in EU Countries

	Male life expectancy at 65	Female life expectancy at 65
Austria	16.9	20.2
Denmark	15.9	19.0
Finland	16.5	20.4
France	17.1	21.3
Germany	16.5	20.1
Italy	16.8	20.5
Netherlands	16.2	19.8
Norway	17.0	20.5
Portugal	16.2	19.6
Sweden	17.4	20.6
Switzerland	18.0	21.4
UK	16.2	19.1
IRELAND	16.0	19.3

Decisions in this area are essentially political. Proposals put into the public domain last year to cut PRSI contribution rates, albeit with a further proposal to remove the contribution ceiling, would result in a net reduction in contributions to the SIF. This would appear to run counter to a genuine commitment to using the State pension as a key instrument in providing a decent level of income for future pensioners. If the State pension is to play this role then the range of policy options outlined in the Green Paper designed to support the financial sustainability of the SIF all need to be teased out and other policy options explored. For example, neither the Mercer review or the Green Paper explore the option of applying PRSI to other sources of income, such as capital gains, beyond those on which it is currently levied.

The 'glass half empty' view of the future sustainability of State pensions inevitably leads to an argument in favour of greater private pension provision. In fact, the

Green Paper (DSFA, 2007: 210, par. 14.8) is quite explicit in stating, "as pressure builds on the cost of Social Welfare pension provision, the need for greater private pension saving will grow if income adequacy in retirement is to be maintained for all". The year 2009 marks the centenary of the introduction of the means-tested Old Age Pension in Ireland at rates of from one shilling to five shillings per week (see Table 1.3). Its introduction had a transformational effect on old age poverty and greatly enhanced the status of older people. O'Grada (2002) has argued that it represented "the most radical and far-reaching piece of welfare legislation enacted in Ireland in the twentieth century". Right through 1908, while the enabling legislation was being debated, the financial sustainability of the scheme was questioned. It will be argued in later sections that one hundred years later, the current debate on future pension provision in Ireland provides an opportunity to position the State pension as a key instrument in delivering adequate incomes for our current and future pensioners.

Table 1.3: Rates of Payment of Pensions in 1909

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PAYMENT OF PENSIONS.

Pensions are paid under a sliding scale, as follows:—

Means of Pensioner.	Rate of Pension.
Where the yearly means of the pensioner	s. d.
Do not exceed £21	5 0
Exceed £21, but do not exceed £23 12s. 6d.	4 0
Exceed £23 12s. 6d., but do not exceed £26 5s.	3 0
Exceed £26 5s., but do not exceed £28 17s. 6d.	2 0
Exceed £28 17s. 6d., but do not exceed £31 10s.	1 0
Exceed £31 10s.	No pension.

The scale of pensions reducing the yearly means to weekly, and leaving out fractions of a penny, is as follows:—

Weekly Means.	Pension per week. s. d.
8s. or less	5 0
Over 8s. and not exceeding 9s. 1d.	4 0
Over 9s. 1d. and not exceeding 10s.	3 0
Over 10s. and not exceeding 11s. 1d.	2 0
Over 11s. 1d. and not exceeding 12s. 1d.	1 0

Section 2: Costs, Returns and Risk

BACKGROUND

The Green Paper is an extensive document (251 pages) and states that it builds on earlier reports (DSFA, 2007: 2, par. 1.1) – such as the National Pensions Policy Initiative (1998), the National Pensions Review (2005), and the report on Special Savings for Retirement (2006), which are all substantial documents.

As well as discussing areas covered in previous reports, the Green Paper also discusses areas not covered are inadequately covered in earlier reports. For example, there is an extensive discussion of social welfare pensions (Chapters 5 and 6) and a recognition that costs in terms of tax expenditures are high and detailed estimates are given (*ibid*: 106). Costs in terms of administering pension schemes are also given recognition (*ibid*: 186-9).

There are several key assumptions made in the Green Paper. One of these is that:

> It is generally accepted that individuals should take responsibility for providing a retirement income by saving during their working lives. (*ibid*: 2, par. 1.4).

As a consequence of this assumption the Green Paper states:

> As pressure builds on the cost of Social Welfare pension provision, the need for greater private pension saving will grow if income adequacy in retirement is to be maintained for all. (*ibid*: 210)

The Green Paper views: "Social welfare pension expenditure represents the liability of the State to provide an income to those who have already retired"(*ibid*: 108, par. 7.44), but omits to say that this liability arises because of social security contributions – for example the minimum number of contributions will double from 260 to 520 by 2012. While it is the case that social security based pensions are not actuarially fair, this is as a result of State policy.

In order to make the case that public pension on spending is 'not sustainable', the Green Paper shows a graph of projections of the cost of Public Service pensions, the cost of Social Welfare pensions and both combined (Figure 3.3 of the Green Paper) all from 2007 until 2050 (*ibid*: 27). However, the graph does not make clear that from 2035 all retiring civil servants will be in receipt of an Old Age Pension and with coordination this will reduce the cost of civil service pensions and hence public sector pensions. This has the effect of transferring part of the cost of civil service pensions to the State Old Age Pension system (*ibid*: 28-9, par. 13.16).

A number of issues are not discussed in the Green Paper. For example, whether pensions should be viewed as savings or insurance. Both approaches to pension provision result in very different systems of pension design and outcomes.

An insurance based system is based on a certain probability that payments will be made. A savings system results in a certain payment or drawdown. As a result in order to produce the same stream of payments pension contributions based on insurance principles must necessarily be lower than pension contributions to produce a savings fund

which forms part of an estate and can be inherited. An individual insurance based pension scheme could be calibrated so that individual life expectancies influenced the size of insurance premia. Those with shorter life expectancy would pay lower premia for the same level of pension payment (see Stewart: 104-5).

The issue of whether pensions should be funded is not discussed in the Green Paper. There is some discussion in an appendix to the National Pensions Review which recognises that the debate on funding fails to recognise that a pension system, whether it is organised on a funded basis or as a Pay-as-you-go (PAYG) system, requires the transfer of future output to future retired persons (Stewart, 2005: 61). In some cases claims have been made that funding can improve economic performance through increased savings rates, or the provision of risk capital. Both of these claims have been made in previous reports by the Pensions Board, but are not included in the Green Paper.

Viewing pensions as equal to savings leads to other issues such as returns and risk. There is a limited discussion in the Green Paper on the nature of risk, although one of the questions for consideration is whether "people are sufficiently aware of the trade-off between risk and the return on investments?" (DSFA, 2007: 147). There is a discussion in the Green Paper comparing the disparity in returns between 1980-1999 and the period 2000-2003, but there is no discussion as to likely future returns. The issue of risk and uncertainty is discussed later in this submission.

RETURNS

The Green Paper cites returns of 9 per cent on pension funds for the period of February 1997- February 2007 (*ibid:* 155, par. 10.35). If charges are deducted (assumed in the Green Paper at 1.5 per cent) and an allowance for inflation is made (approximately 3 per cent per annum) returns are 4.5 per cent real. But the Green Paper does not discuss why such returns might continue in the future. It is assumed that a portfolio approach to investment as in the discussion on managed pension fund returns will ensure that returns are positive. This in turn leads on to the question as to who will manage funds and organise the collection of pension contributions and disbursement of payments? All of these activities result in costs in terms of charges. A key question to consider is how to ensure these costs are transparent and how they might be controlled, but this is not identified as a key question in the Green Paper (See Green Paper, p. 198). A related but important issue is that there is considerable variation in charges so that charges may be higher for smaller schemes and for individual pensions such as Additional Voluntary Contributions (AVCs) and insurance products.

The net effect of pension provision in the private sector through complex financial products with a potential life span of 60 years or more is that the pensions industry requires extensive regulation. While the Green Paper questions whether "increased regulation" has increased costs (*ibid:*191, par. 12.99), the Green Paper does not make the case that effective regulation can benefit firms in the pensions industry by removing the threat of 'unfair competition' through minimum standards and disclosure by those providing pension services. However this raises the issue of what is 'fair competition'.

The Green Paper states: "That active competition in the market place should lead to downward pressure on the costs of services provided to funded supplementary pension arrangements" but also goes on to comment that without detailed information on charge

levels it is not possible to state if this is or is not the case in the Irish supplementary pensions market place" (*ibid*: 191, par. 12.104). The Green Paper also acknowledges that: "There is a lack of detailed knowledge of the cost of providing funded supplementary pension arrangements in a voluntary regime in Ireland" (*ibid*: 194, par. 12.120).

There is thus little evidence on which to base policy. The Green paper does consider how this 'information deficit' might be addressed by the Pensions Board (*ibid*: 195, par. 12.122), but this issue is not regarded as a key question (*ibid*: 198).

WHAT IS THE PROPOSED SOLUTION TO REGULATORY ISSUES IN THE GREEN PAPER?

The proposed solution to charges in the Green Paper is greater transparency (*ibid*: 196. par. 12.131), and education ("the inclusion of financial planning in the school curriculum" (*ibid*: 184, par. 12.54). But the Green Paper also recognises that current market structures are inherently uncompetitive. For example the Green Paper states: "Life companies have a number of actual and de facto monopolies in the provision of certain products and services to the pensions marketplace" (*ibid*: 192, par. 12.106). In addition, market concentration also exits in the provision of advisory and administration services (*ibid*: 193, par. 12.114). This poses a particular problem as the Green Paper recognises that "trustees rely on professional providers" (*ibid*: 185, par. 12.59). Indeed the same firm may both act as a trustee and provide professional advice, leading to issues of conflict of interest.

However, despite the recognition in the Green Paper of inherently uncompetitive markets, the Green Paper specifically rejects control over charges (*ibid*: 193, par. 12.115).

COSTS AND RETURNS

Costs in terms of charges are important in affecting returns but if returns are high and risks are low, costs are of less significance. For example, if mean returns are 20 per cent per annum, costs 1.5 per cent, and annual inflation is 4 per cent, real returns are 14.5 per cent. But with lower returns, costs and risks become more important. Since the Green Paper the economic environment has changed:

- Low growth
- Reduced population inflows or possible population outflows
- Falling government tax receipts
- A credit crisis and falling stock markets

It is likely that Irish Pension Funds have suffered losses due to the subprime and credit crisis. Although, the collapse of International Securities Trading Corporation (ISTC) is the only documented cause of pension fund losses (Kathleen Barrington, *Sunday Business Post*, 25 November 2007). In addition, stock markets have fallen in all major markets over the past 12 months. This means that deficits in Defined Benefit (DB) schemes will have widened. While Defined Contribution (DC) schemes will not deliver

adequate returns to ensure adequate pensions even if contributions had been higher. It is highly likely that there will be future cycles in stock market returns. Returns over a time period can fluctuate, with a large impact on accumulating lump sums. This is illustrated in Table 2.1, which shows the required level of savings to produce a pension equal to half an annual salary of €40,000. As the Social Welfare pension is assumed to be €193 per week, a lump sum is required to provide the remainder or €207. The Table shows the value of a lump sum which accumulates over 21 years with and without charges and assuming constant growth every year of 6 per cent. The value of the same lump sum is also shown assuming that every seven years there is a capital loss of 12 per cent at the end of the year. Table 2.1 shows that assuming charges of 1.5 per cent in terms of Reduction in Yield (RIY), and a capital loss every seven years, the lump sum is approximately 70 per cent of that estimated to be required to provide the non-social welfare component of a pension.

Table 2.1: The Value of a Future Lump Sum as Assumptions Vary

	Example 1 €700 per month, for 21 years, no charges, 6% return	Example 2 €700 per month for 21 years, 1.5% charges 4.5% net return	Example 3 €700 per month for 21 years, no charges, 6% return, but 12% capital loss every 7 years	Example 4 Example 3 €700 per month for 21 years, 1.5% charges, 4.5% net return, but 12% capital loss every 7 years
Accumulated lump sum after 21 years	€311,039	€259,980	€264,949	€222,099

Note: Adapted from "How Much do you Need to save for a Pension, Society of Actuaries, May 2006, (reproduced in Green Paper p. 137).
Assumptions: As in Table 9.2 Green Paper, salary €40,000, pension of 50 per cent, current age 44, planned retirement at 65, monthly pension contribution is €700. Returns are assumed to be 6 per cent per annum gross of costs. Cost assumptions are not clear (See, Society of Actuaries GN31A). We assume 1.5 per cent RIY. Gross loss every seven years is 12 per cent or net of returns 6 per cent.

This example provides an example of 'straight line thinking' which pervades discussion of pension issues. The assumption is that a particular assumed trend will continue as a straight line over long periods (see for example data taken from the Society of Actuaries 2006, on recommended contributions to pensions). Investment managers, managers of pension funds and others collectively seem to be surprised by events such as the dot.com crash, the more recent credit crisis, and by changes in longevity. The Myner Report for the UK shows considerable convergence in investment strategies or 'herding behaviour' by UK based investment managers (Myners Report, 2001: 55-6), and a focus on short run returns (*ibid*: 88).

WHAT ABOUT ACTUAL RETURNS?

The Green Paper does note the much lower returns to pension fund investments between the period 1980-1999, and 2000-2003. The 'credit crisis' is too recent to be included. Over one year the Irish Stock Market index fell from approx 10,000 to 6,200 – a 38 per cent fall. Over a four year period the index rose from 4,200 to 6,200 and over seven years

from April 2001 – April 2008, the index changed little in value. As costs are likely to be or nearly equal to income, nominal returns have been zero, and real returns have been negative. The main returns to any pension scheme whose assets were invested entirely in the Irish stock market has been via tax reliefs. In other words an exchequer subsidy.

The Green Paper has very little discussion of risk or uncertainty, or the difference between these two concepts. In the case of risk we know the probability distribution of outcomes. But in the case of uncertainty we do not know the probability distribution of outcomes. Those unforecast and unexpected outcomes that have severe or catastrophic consequences are sometimes referred to as "A Black Swan" from the book by Taleb (2007). Some examples are population projections, underestimating longevity, the dot.com crisis, and the credit crisis.

The most recent financial crisis has resulted in losses to banks of $300 billion by April 2008 and one forecast is an eventual loss of $750 billion. It is inconceivable that Irish Pension funds have not lost considerable sums via the collapse of structured investment vehicles (SIVs), collateralized debt obligations (CDOs), hedge funds and other complex financial instruments.

The Green Paper assumes a regime of certainty that projections on which policy is based can be made today in relation to financial returns, population flows, etc. to 2050 or 2060.

CONCLUSION

The essential point of a pension system is to transfer future resources from those at work to those not at work. The key issues that need to be addressed are: what is the most efficient means of achieving this transfer? What is the lowest risk? What is equitable?

No pension system can be organised without cost and without risk but some pension systems have lower cost and risk than other systems. We argue in the next section that a universal PAYG State pension is lower cost and lower risk than a funded system organised in a pensions industry which is not competitive and locked into high risk investment strategies. Our pension system should move from a high cost, high risk system to a low cost low risk system. This can be best achieved by a universal State pension system not a funded system.

Section 3: Public and Private Pension Provision and Options for Eliminating Pensioner Poverty

REASONS FOR PENSION REFORM

The Green Paper sets out the problems that Ireland's pension system is now facing and the problems it is expected to face in the future. The main problems identified in the Green Paper are:

- the high level of pensioner poverty
- the low level of coverage of the private pension system and the provision of an adequate replacement income on retirement
- ageing of the population and the sustainability of the public pension system

The Green Paper does not identify the cost and unequal distribution of pension tax reliefs as a problem. This is a serious omission because the cost of these reliefs is one of the factors that threatens the long-term sustainability of the public pension system and they are distributed in a way that allows most of their benefits to be appropriated by high earners. Members of the Pension Policy Research Group (PPRG) have pointed out in two books published by TASC that the cost and distribution of pension tax reliefs are issues which ought to be addressed in reforming Ireland's pension system (see Stewart, 2005; Hughes and Stewart, 2007). The Organisation for Economic Co-operation and Development (OECD) has also drawn attention to the cost and poor targeting of the pension tax reliefs and their limited effect on saving (see OECD, 2008: Chapter 5).

The Green Paper treats the problems of the public and private pension systems separately and outlines options for reforming each component which do not take into account the total resource cost of the pension system as a whole. The alternatives considered for reforming the public system in order to address the issue of pensioner poverty are:

- to increase the level of the Social Welfare pension[2]
- to introduce a universal State pension

The Green Paper is pessimistic about the possibility of increasing the level of the Social Welfare pension unless it is done in conjunction with cost saving measures such as

[2] The structure of the Irish pension system is relatively simple. It is based on a partnership approach between government, employers and employees. It consists of a compulsory State social insurance system which pays flat rate benefits and a voluntary private system which is subsidized through the tax system. The social insurance system provides a State Pension (Transition) at age 65 which requires withdrawal from the labour force for one year and a State Pension (Contributory) at age 66 which does not require withdrawal from the labour force. In addition there is a means-tested State Pension (Non-Contributory) for those not covered by the social insurance system. The amounts paid by the transition and contributory pensions are the same while the non-contributory pension has usually been about 10 per cent less than the social insurance pension. For convenience, these three pensions will be referred to as the Social Welfare pension where it is not necessary to distinguish between them.

increasing the retirement age or reducing public spending elsewhere. It acknowledges that a universal State pension would resolve the anomalies in the existing social insurance and social assistance pension arrangements but argues that it would result in a significant increase in costs and that it would be a radical departure from the present system.

The options outlined for addressing the low level of private pension coverage are:

- to grant the incentive for A Personal Retirement Savings Account (PRSA) personal contributions as a matching contribution from the State of €1 for each €1 invested
- to provide additional support for the current voluntary system by giving tax reliefs at the highest marginal rate of tax for all personal contributions
- to introduce mandatory or soft mandatory personal pension accounts

These options were originally suggested by the Pensions Board (2005). The Board appears to assume that increasing coverage of the private pension system to 70 per cent for workers aged 30 and over would ensure that supplementary pensions in combination with a social insurance pension replacing 34 per cent of average earnings would be sufficient to replace at least 50 per cent of pre-retirement earnings. However, it provides no evidence to show that achieving the coverage target would provide pensioners with an average income from private pensions sufficient to achieve the 50 per cent target.

We shall argue in this paper that changes in the private pensions market in the last decade or so make it less likely that the target income can be achieved. In the past most of the pension schemes provided by employers were defined benefit plans. Consequently, they provided benefits that would have enabled employees who had spent most of their working life with one employer to replace up to two-thirds of their pre-retirement earnings. In the last ten years or so many defined benefit schemes have been closed to new entrants and replaced by defined contribution schemes in which all of the investment risk is borne by employees rather than employers. Most employers are no longer willing to provide any undertaking about the level of occupational pension benefits for new entrants. The benefits that a member of a defined contribution scheme can expect will depend on how much is contributed to the scheme, how well the scheme is managed and the performance of stocks, shares and other assets.

The Green Paper acknowledges that increasing private pension coverage has been difficult despite the generous tax incentives on offer. Nevertheless, it suggests that the level of supplementary pensions could be improved by increasing the tax incentives for the current voluntary approach to occupational and personal pensions and introducing a mandatory or a soft mandatory personal pension for those not covered by occupational schemes.

Although the Green Paper puts forward no explicit proposals for the development of the pension system, the options considered and the arguments made for and against them suggest that the current policy of limiting the role of the public pension system and relying on the private pension system to increase coverage and pension benefits in the future is generally effective in preventing pensioner poverty and providing adequate incomes in retirement. Implicitly, the prescription in the Green Paper for making further progress towards these goals is to continue to limit the role of the public system and to increase tax incentives for private pensions.

The Pension Policy Research Group (PPRG) believe that this approach has not worked in the past and that it is unlikely to be successful in the future. It presents evidence in this paper from the performance of the public and private components of the pension system in terms of adequacy, cost, equity, coverage, efficiency, and sustainability which shows that the public pension system has failed to prevent high levels of pensioner poverty, that the subsidies for the private pension system are now costing as much as the public system, and that the private pension system mainly benefits only a small minority of taxpayers and pensioners.

The options which TASC and the Pension Policy Research Group prefer require greater reliance on the public pension system and less reliance on the private system. They also require that the Exchequer cost of the two components should be compared in order to assess which component is more effective in delivering pensions for older people. The options which will be put forward by the PPRG later in this paper could help Ireland to solve the problem of pensioner poverty, to provide fairer treatment for the majority of taxpayers who derive little benefit from the existing tax treatment of pension funds, and to improve the long-term sustainability of the public pension

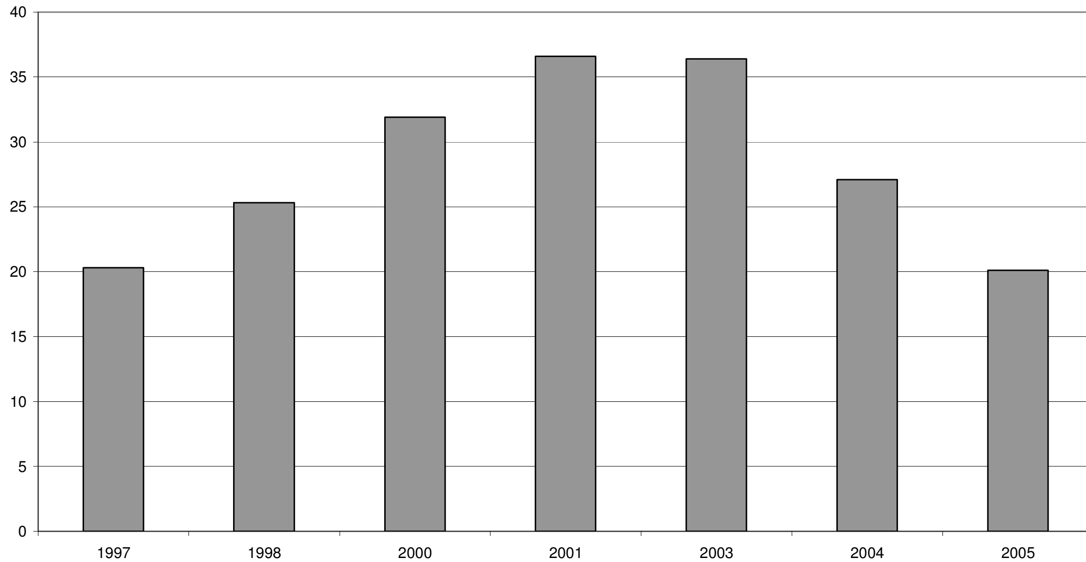
PENSIONER POVERTY RATES AND THE LEVEL OF STATE PENSIONS

Despite considerable efforts in recent years to reduce poverty among pensioners by increasing the Social Welfare pension and developing the private pension system, the pensioner poverty rate in Ireland has remained stubbornly high. Figure 3.1 shows that the pensioner poverty rate during the last twenty years or so has fluctuated from 20 to over 35 per cent and has averaged 29 per cent over the whole period.

These are very high rates of pensioner poverty when compared with pensioner poverty rates in other countries. In Figure 3.2 a comparable measure of relative income poverty is presented for all EU25 countries. It shows that Ireland had the second highest rate of pensioner poverty in the European Union in 2005. About one-third of those aged 65 and over in Ireland were at risk of poverty using the 60 per cent line compared with an average of 19 per cent for the EU25 countries.

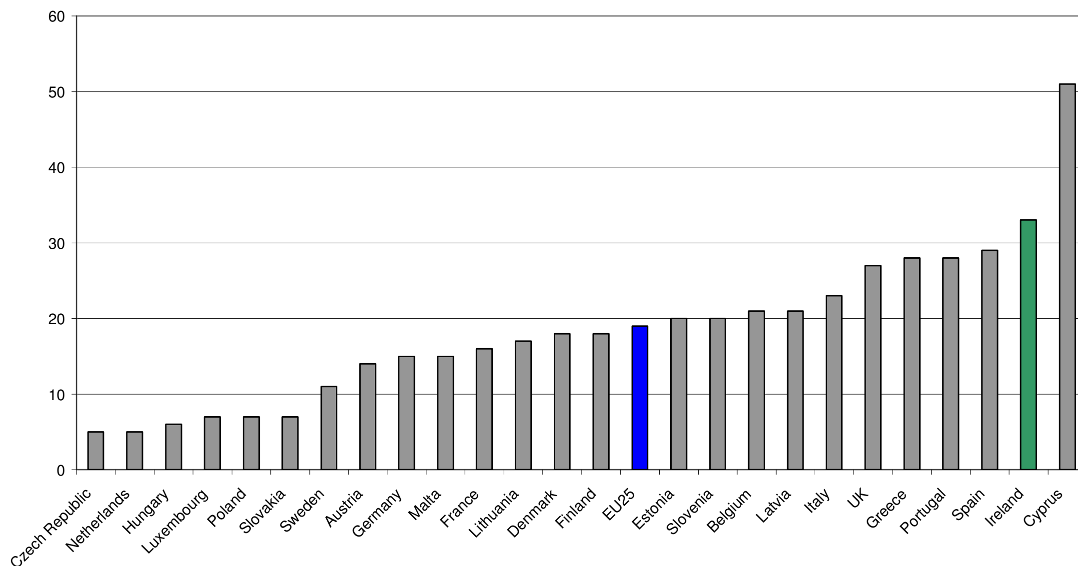
Figure 3.3 suggests that the main reason for high levels of pensioner poverty is that the level of the contributory and non-contributory pension has been set over the last twenty years at a level that is too low relative to the poverty line. Figure 3.3 shows that for most of the period since 1997 the level of the State social insurance pension for a person has been set consistently too low relative to the 60 per cent at risk of poverty line to eliminate pensioner poverty. It also shows that when the gap between the target and actual income level narrows the pensioner poverty rate falls while the opposite is true when the gap widens.

Figure 3.1: Percentage of Those Aged 65 and Over At Risk of Poverty Relative to the 60 Per Cent Poverty Line, 1987-2005



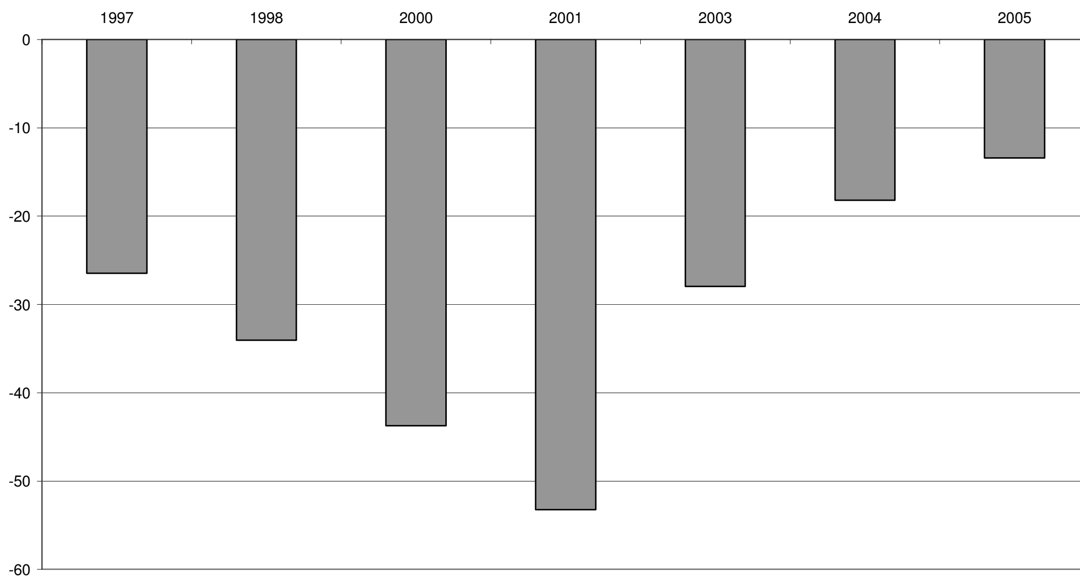
Source: Ireland, Whelan, Layte, Maitre, Gannnon, Nolan, Watson, Williams (2003), Tables 4.13 & 4.16 and Central Statistics Office (2005), Layte, Fahey and Whelan (1999, Table 3.8).
Note: The poverty measure is based on mean income up to 2003 and on median income thereafter.. Although the Living in Ireland survey which supplied the data for the period 1997-2003 was replaced in 2004 by the EU Survey of Income and Living Conditions (EU-SILC) the results for 2004 and 2005 are broadly comparable with those for the earlier years, as the CSO (2005) points out.

Figure 3.2: Percentage of Those in EU25 Countries Aged 65 and Over At Risk of Poverty Relative to the 60 Per Cent Poverty Line in 2005



Source: Department of Social and Family Affairs (2007, Table 4.19).

Figure 3.3: Poverty Gap Showing the Difference Between the State Personal Social Insurance Pension and the 60 Per Cent At Risk of Poverty Line



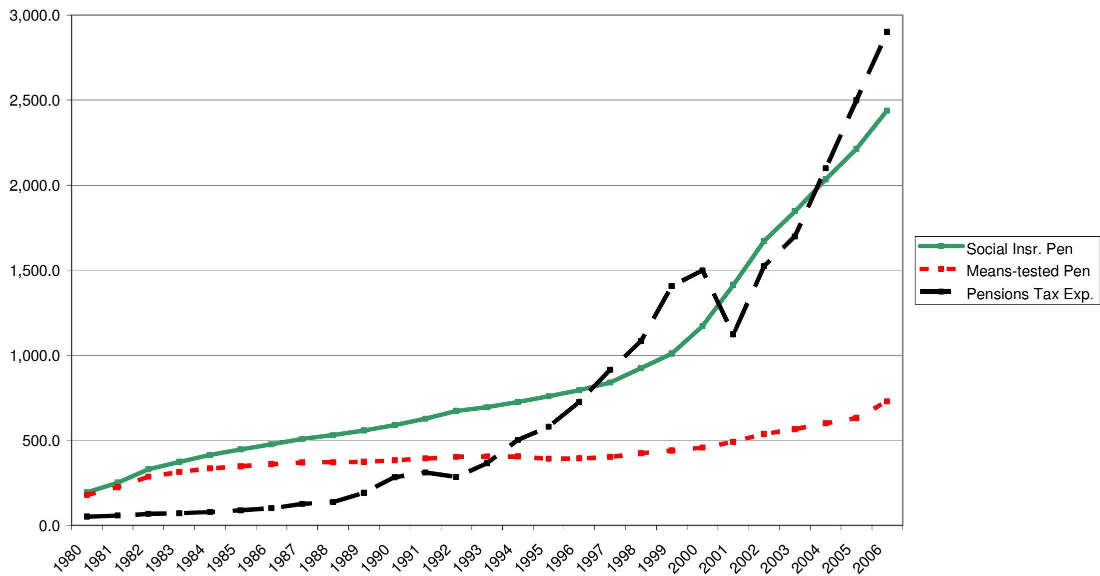
Source: McCashin (2007, Table 5.1)

PROBLEMS OF THE PRIVATE PENSION SYSTEM

Ireland has operated a very favourable tax regime for pensions in order to encourage the development of the private pension system. Figure 3.4 indicates that the cost of these tax reliefs was fairly modest initially but it is now growing rapidly with the value of pension assets equal to €88 billion, or 60 per cent of GNP, at the end of 2006. In 1980, the earliest year for which the Revenue Commissioners estimated the cost of the tax reliefs, they amounted to around €50 million, or 26 per cent of what was spent on social insurance pensions and 28 per cent of the cost of means-tested pensions. By the early 1990s the cost of the pensions tax expenditure had built up to around half of the cost of social insurance pensions and about 90 per cent of the cost of means-tested pensions. In 2006 the cost of the tax expenditure amounted to nearly 120 per cent of the cost of social insurance pensions and nearly four times the cost of means-tested pensions.

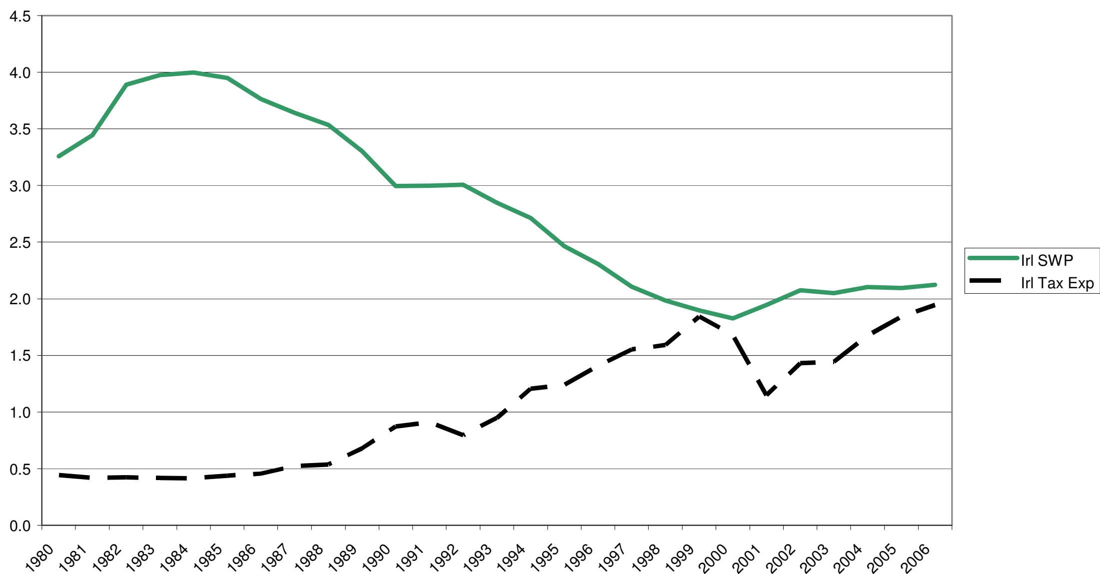
Figure 3.5 shows the cost of public expenditure and tax expenditure on pensions in Ireland relative to GNP over the period 1980-2006. At the beginning of the period in 1980 the cost of the Social Welfare pension was 3.3 per cent of GNP while the cost of the pension tax expenditure was 0.4 per cent of GNP. The cost of the Social Welfare pension increased to 4 per cent of GNP up to the mid-1980s while the cost of the pension tax expenditure remained around one-tenth of that, 0.4 per cent of GNP. From the mid-1980s to 2006 the cost of the Social Welfare pension fell continuously to about 2 per cent of GNP. In contrast to this downward trend the cost of the pension tax expenditure tripled to 1.7 per cent of GNP between 1986 and 2000 as the government pursued its policy of developing the private pension system. Between 2000 and 2001 the cost of the pension tax expenditure fell as a result of the collapse of the "dot com" bubble. However, it

Figure 3.4: Direct Expenditure on Social Insurance Pensions and Means-Tested Pensions and Tax Expenditure on Private Pensions, Ireland 1980-2006 (€million)



Source: Annual Statistical Reports of the Department of Social and Family Affairs and the Revenue Commissioners and Department of Social and Family Affairs (2007, Table 7.2)

Figure 3.5: Public Expenditure on Social Welfare Pension and Tax Expenditure on Private Pensions, Ireland 1980-2006

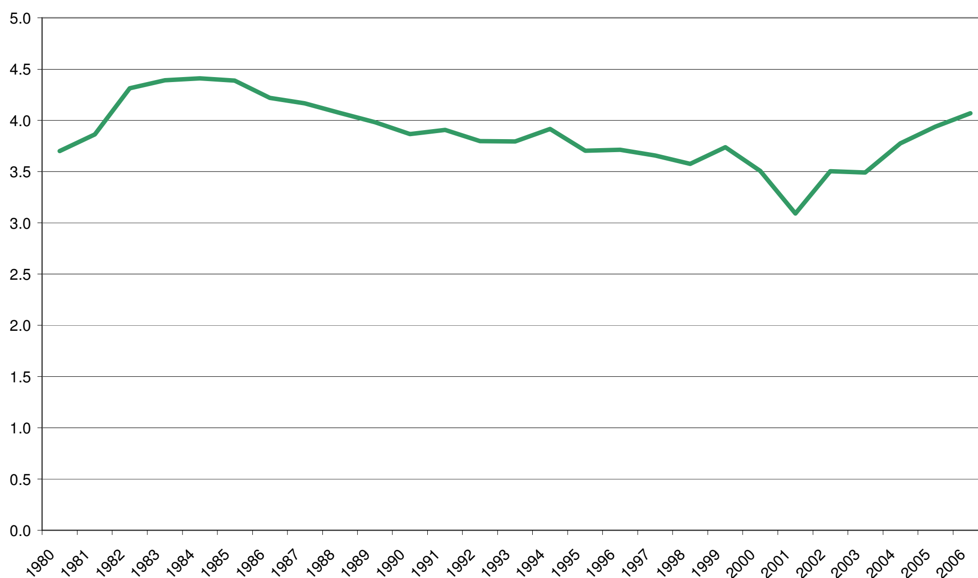


Source: As for Figure 3.4.

recovered quickly and it has now risen to a net cost of 1.9 per cent of GNP. The cost of Exchequer support for the public and private pension systems in Ireland is now virtually identical at around 2 per cent of GNP in each case.

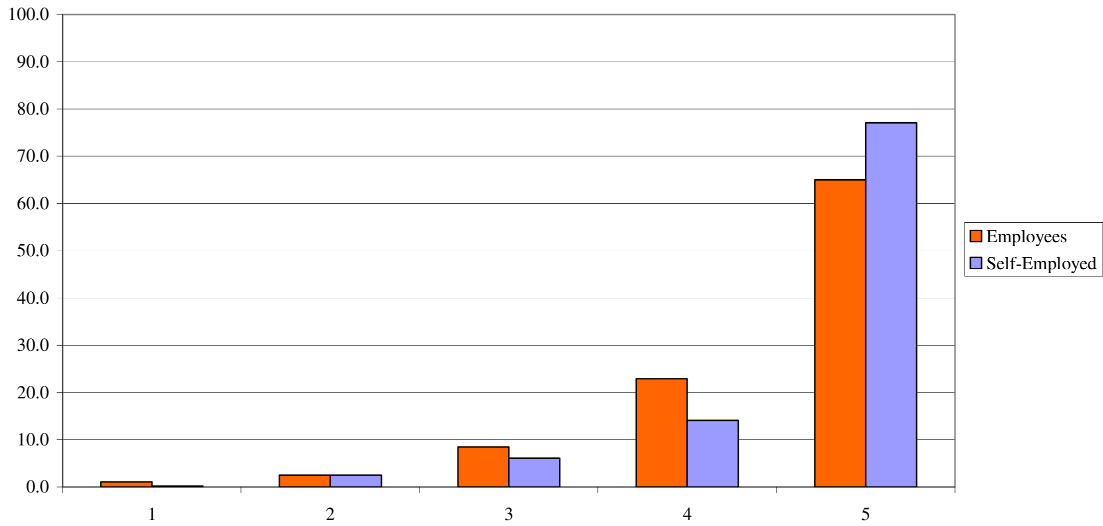
Adding the cost of the tax reliefs for private pensions to the cost of public expenditure on pensions in Figure 3.6 provides a different perspective on the issue of the affordability of a universal State pension in Ireland. The addition of the tax expenditure on the private pension system in Ireland indicates that the resource cost of supporting the public and private pension systems fell from around 4.5 per cent of GNP in the early 1980s to a low of around 3 per cent in 2001. It then increased to around 4 per cent in 2006 following government commitments given in 2001, and subsequent years, to increase the level of the State contributory pension. This means that Exchequer support for pensions has fallen over most of the last quarter century while the balance between support for public and private provision has been allowed to shift fairly steadily in favour of private provision.

Figure 3.6: Expenditure on Social Welfare Pension and Pension Tax Expenditure as Percentage of GNP, 1980-2006



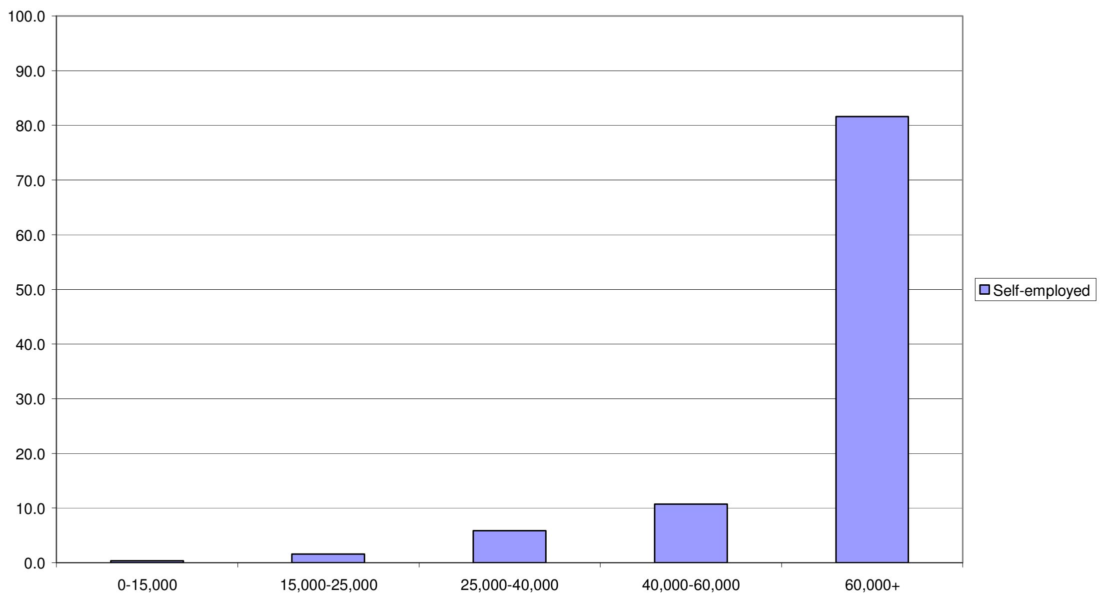
A major consequence of this shift in favour of private provision is that State support for private pensions has been largely appropriated by higher income groups rather than by middle and lower income groups who are most in need of State support for an income during retirement. Figure 3.7 shows the distribution by income quintile of the tax reliefs on self-employed and employee contributions to occupational pension funds in Ireland in the year 2000, the latest year for which estimates are available for both groups.

Figure 3.7: Distribution by Income Quintile of Pension Tax Reliefs on Employees' Contributions and Self-Employed Contributions Around 2000



Source: Hughes (2007, Figure 3.12)

Figure 3.8: Distribution of Tax Reliefs on Pension Contributions by the Self-employed by Quintile, 2003



Source: Estimated from data in Appendix D of the Green Paper (see Department of Social and Family Affairs, 2007)

The distribution for employees and the self-employed is much the same. The bulk of the tax reliefs accrue to the top 20 per cent of earners while the bottom 20 per cent receive virtually nothing. Two-thirds of the tax reliefs for employees and three-quarters of the reliefs for the self-employed accrued to the top 20 per cent of employees and self-employed respectively with the highest incomes in the year 2000. The bottom 20 per cent of employees and of the self-employed received only 1.1 per cent and 0.2 per cent respectively of the tax reliefs. The distribution of the tax reliefs for the self-employed is more concentrated than it is for employees because the pension coverage rate for the self-employed is significantly lower than it is for employees.

Figure 3.8 summarises information from the Revenue Commissioners, given in the Green Paper, on the distribution of pension tax reliefs for the self-employed in 2003. The distribution of pension tax reliefs for the self-employed was even more concentrated in 2003 than it was in 2000. The top 20 per cent of the self-employed received 82 per cent of the benefits in 2003 compared with 77 per cent in 2000. The reason for the increase in concentration may be due to the removal, in the Finance Acts of 1999 and 2000, of the requirement for the self-employed to purchase an annuity on retirement. Subject to minimal restrictions, these Acts allow the self-employed, and some other categories of pensioner, to choose between investing their retirement assets in an Approved Retirement Fund (ARF) and purchasing an annuity. The Minister for Finance said that his intention in introducing the option of an ARF was to allow the self-employed to manage their own assets in retirement as they had adequate experience of managing their own assets during their working life.

It was expected that the ARFs would be gradually reduced in the draw down phase following retirement. This expectation has not been realised. It was discovered in a review of certain pension tax reliefs by the Department of Finance that in 2005 only around 6 per cent of ARFs were being used to provide a regular income. A further 5 per cent were used for irregular withdrawals and the remaining 89 per cent were being used by high earners as a tax advantaged savings scheme. The Department of Finance concluded:

> The intention of the ARF legislation was to develop an alternative flexible income stream in retirement which would obviate the necessity for annuity purchase. Based on the evidence available … it appears that this is not happening. Rather it could be said that ARFs have allowed the diversion of retirement provision into simple tax-advantage savings schemes for those who do not need them to produce a regular income stream. (Department of Finance, 2005: 22)

The Department went on to note:

> … that for those who have the capacity to survive in retirement without the need to rely on funds invested in an ARF, our "EET" system of pension taxation is much closer to an "EEE" system where effectively no tax is paid, or if it is, it is at a low rate and far into the future.[3] (*ibid*: 22)

[3] An "EET" system is one in which the employer and employee contributions to a pension fund are exempt (E) from tax, the investment income and capital gains are also exempt (E) from tax and the pension benefit is taxed (T) in payment. An "EEE" system is one in which all three components are exempt from tax.

Following this review the government set the annual limit on tax relieved individual pension contributions at €254,000 and introduced a lifetime limit of €5 million on the accumulated pension fund. It also made ARFs subject to income tax as if not less than 3 per cent of the fund were drawn down each year. These limits are indexed in line with changes in average weekly earnings of industrial workers in all industries. They are estimated to affect less than 1 per cent of taxpayers[4]. The OECD points out that these limits "imply large tax concessions up to a very high level of wealth compared to the average citizen" (OECD, 2008: Chapter 4, note 8).

The OECD also notes in relation to the private pension system as a whole that the tax exemption limits for those aged 65 and over mean that "a tax system that aims for pension savings, returns and income to be subject to an 'exempt-exempt-tax' (EET) regime is in effect fairly close to being an 'exempt-exempt-exempt' (EEE) system where income channelled through pensions is unlikely to be taxed at any point of the life-cycle" (2008: 90).

As the primary purpose of pension tax reliefs is to increase the coverage of the private pension system, one would expect the coverage of occupational pension schemes to have risen over the years. One would also expect that the private pension system would be a more important source of retirement income than the public pension system for those who belong to a private pension plan as Social Welfare pensions are payable at a flat rate whereas private pensions are earnings-related. What, therefore, has been the trend in private pension coverage and how effective have the public and private components of the pension system been in delivering pensions to older people?

TRENDS IN THE COVERAGE OF OCCUPATIONAL PENSIONS

Figure 3.9 shows what has happened to the occupational pension coverage rate over the last twenty years or so. Contrary to expectations, the occupational pension coverage rate declined by 8 percentage points from 44 per cent to 36 per cent over the period 1985-1999. It grew by 4 percentage points from 1999 to 2006 so that some of the ground lost has been recovered. A factor which may have contributed to this recovery was the very strong employment growth experienced between 1995 and 2006 when Ireland's economy grew at rates that were unprecedented since Independence in 1921. Nevertheless, the overall coverage rate was lower in 2006 by 4 percentage points than it was in 1985.

It is evident, therefore, that the policy of providing generous tax reliefs to encourage the growth of occupational pension schemes has not been very effective in increasing pension coverage over the last twenty years. This failure has been compounded by a switch in coverage from occupational defined benefit schemes to defined contribution schemes as Figure 3.10 shows. The switch to defined contribution schemes puts a big obstacle in the path to the achievement of the Pensions Board target of replacing 50 per cent of pre-retirement income because the difference between the target for the social insurance pension (34 per cent of average earnings) and the overall target has to be made up by a private pension. The decision by employers to replace defined benefit with defined contribution schemes for most new entrants to the labour force means that there can be no certainty about what level of pension the private sector can deliver to the average pensioner.

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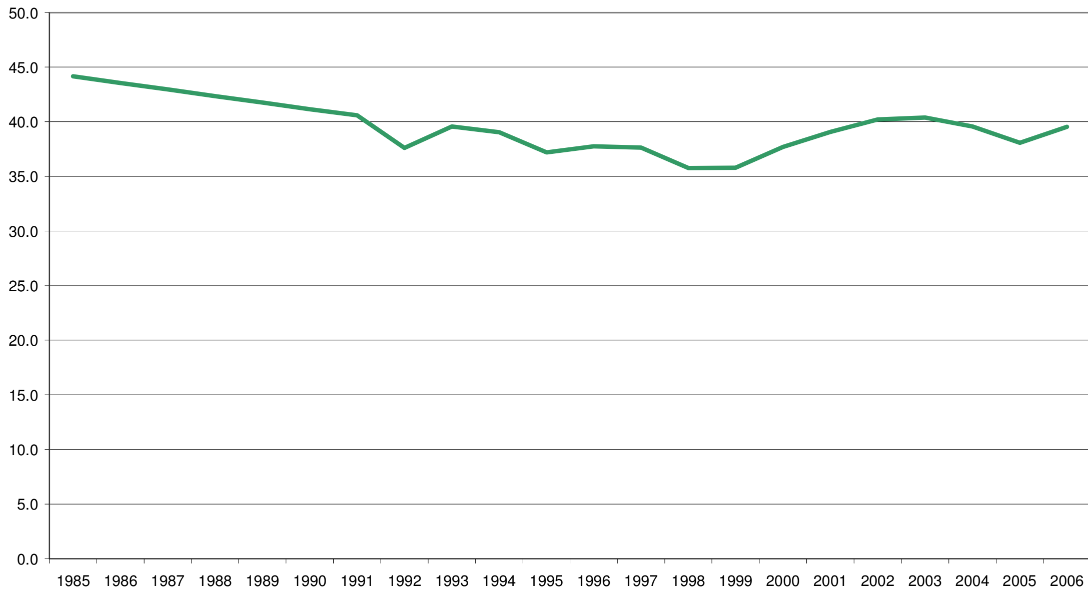
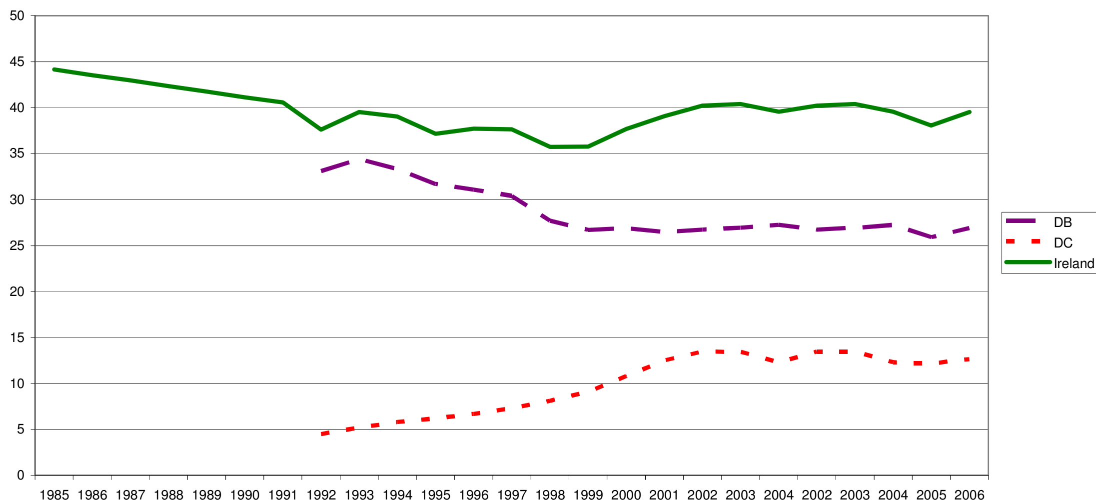
[4] For further information on subsequent developments in relation to ARFs see Hughes (2007).

Figure 3.9: Occupational Pension Coverage Rates, 1985-2006



Source: Ireland, Hughes (2007, Figure 3.13).

Figure 3.10: Percentage At Work Covered by DB & DC Occupational Pension Schemes, 1985-2006



Source: Pensions Board Annual Reports

Despite the uncertainty surrounding the average level of pension that can now be delivered by the private pension system, Ireland has put a lot of effort during the last ten years into the development of a personal pension option in the hope that it would help to increase the pension coverage rate. The government's advisory body on pensions, the Pensions Board, identified a number of barriers to improving pension coverage (see Pensions Board, 1998). It recommended that a standardised, low cost personal retirement savings option should be made widely available irrespective of employment status. The government accepted the Board's recommendation. It introduced the Personal Retirement

Savings Account (PRSA) in 2003 for employees and others not covered by an occupational scheme or a Retirement Annuity Contract. It made it mandatory for employers to designate a PRSA provider but it did not require the employer to make a contribution on behalf of employees. Age related tax incentives were provided to encourage people to start saving for retirement. Anyone aged under 30 taking out a PRSA is allowed to claim tax relief on contributions up to 15 per cent of earnings while those aged 60 and over are allowed to claim tax relief on up to 40 per cent of earnings. PRSAs operate like defined contribution pension plans but their charges are considerably higher than those for occupational schemes as they do not generally benefit from the economies of scale accruing to group schemes.

It was hoped that these tax reliefs, and the mandatory requirement for employers to provide access to a PRSA, would help to increase pension coverage of those aged 30 and over from 54 per cent in 1995 to 70 per cent within ten years of the introduction of the PRSA. This expectation has not been realised. Two years after the introduction of PRSAs only 1 per cent of employees and 2 per cent of those not at work were contributing to a PRSA. In view of this disappointing performance, the Minister for Social and Family Affairs requested the Pensions Board to bring forward by one year a scheduled review of the pension system. Four months after receiving the Pensions Board (2005) report the Minister requested it to explore the general principles relating to a mandatory or quasi-mandatory pension system and to recommend the most appropriate system for Ireland. The Board presented a technical review of the issues (see Pensions Board, 2006) and identified a mandatory scheme that would be appropriate for Ireland. However, it adopted a neutral position on the option it favoured noting that "it is not a recommendation by the Board for or against the introduction of a mandatory system" (Pensions Board, 2006: 10).

The Green Paper considers the option of a mandatory or quasi-mandatory addition to the Irish pension system and concludes "It would be useful, perhaps, to allow time for more evidence on performance of soft mandatory schemes elsewhere to emerge, particularly from New Zealand" (DSFA, 2007: 128, par. 8.54).

EFFECTIVENESS OF PENSION DELIVERY

The effectiveness of the public and private approaches to pension provision in delivering pensions is assessed in terms of coverage and share of income provided. Figure 3.11 evaluates effectiveness in terms of the percentage of pensioner couples receiving incomes from different sources in 2000. Figure 3.12 considers effectiveness in terms of the percentage of total income provided by each source.

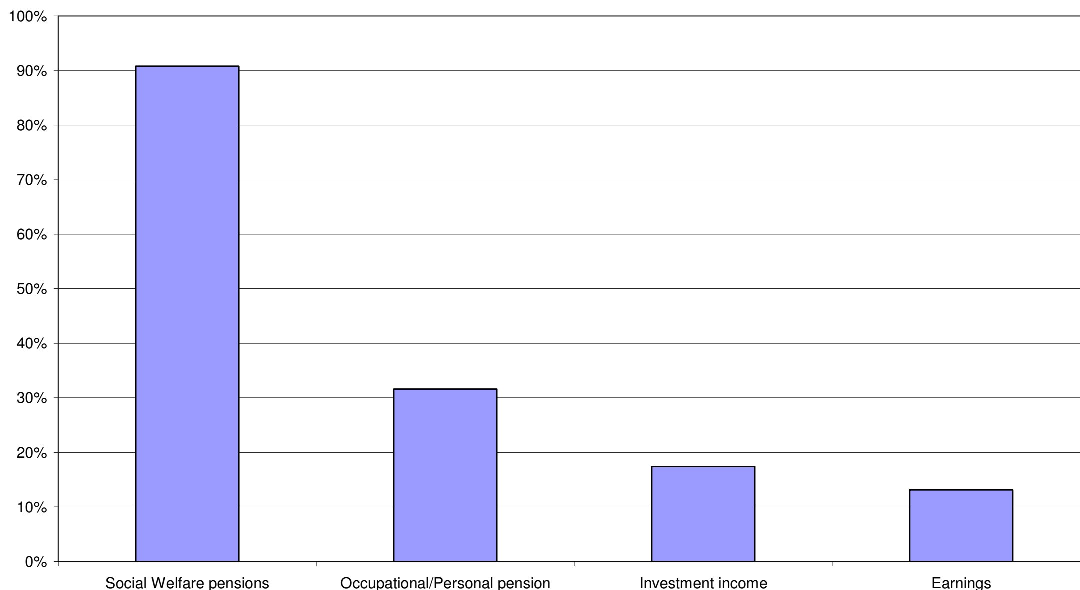
Figure 3.11 indicates that State pensions and other State benefits provided an income for the great majority, 91 per cent, of pensioner units whereas private pensions provided an income for only a minority, 32 per cent, of pensioner units in 2005. Investment income and earnings are significantly less important than private pensions as sources of income for pensioners with investments providing only 17 per cent and earnings 13 per cent of retirement income. It is evident from the comparison in Figure 3.11 that the public pension system is far more effective than the private pension system in delivering an income in retirement to older people. The public pension system is now quite close to providing a universal benefit for older people. The present combination of

social insurance and means-tested social assistance pensions make the receipt of a pension contingent on a relatively unbroken performance in the labour market, which particularly disadvantages women and atypical workers, or satisfaction of an enquiry by Social Welfare officials which carries a stigma for many of those likely to be subjected to it.

The emphasis on private pension provision in Ireland suggests that it should play the leading role in providing retirement income; Figure 3.12 shows that this is not the case. The most important contribution to the total income of pensioners is made by Social Welfare pensions and other social benefits. The public system accounts for 60 per cent of pensioners' total income whereas the private system provides only a small part of total income, 24 per cent. Investment income and earnings account for relatively minor shares of total pensioners' income.

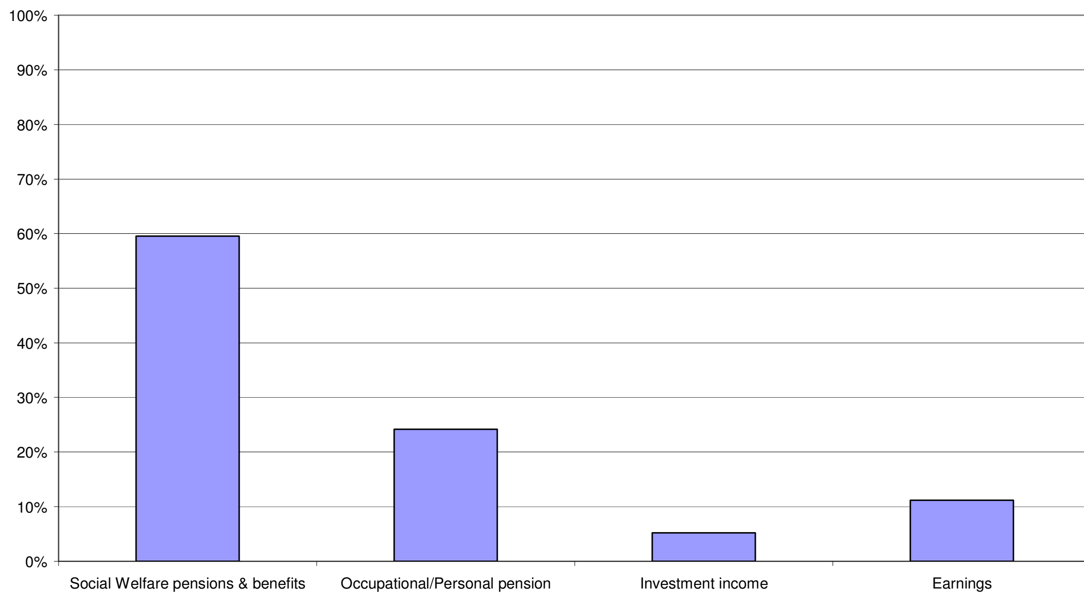
The minor role that the private pension system and other sources of income play in providing retirement incomes becomes even more evident when the average data in Figure 3.12 are disaggregated by income quintile to show what percentage of the total income of pensioners in different parts of the income distribution is provided by public and private sources. This is done in Figure 3.13 where it shows that Social Welfare pensions account for over 80 per cent of the income of pensioners in the first, second and third quintiles of the income distribution and that they account for over 75 per cent of the total income of pensioners in the fourth income quintile. The only group of pensioners for whom private pensions provide a significant part of total income is the group at the top of the income distribution. For this group around forty per cent of their total income in retirement is provided by the private pension system. This is hardly surprising as the bulk of the tax reliefs for pension saving are appropriated by the highest earners, as has been shown below.

Figure 3.11: Percentage of Pensioner Units Receiving Income from Each Source, 2005



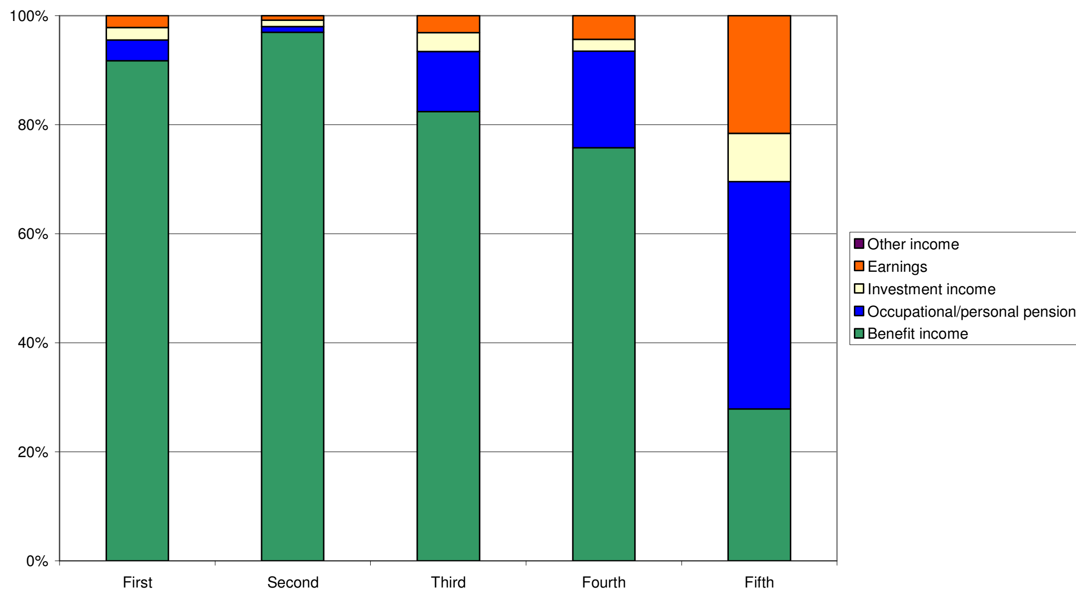
Source: Ireland, Department of Social and Family Affairs (2007, Table 4.1).

Figure 3.12: Percentage of All Pensioner Units Income Provided by Each Source, 2005



Source: Ireland, Department of Social and Family Affairs (2007, Table 4.1).

Figure 3.13: Percentage of Pensioner Units Income Provided by Each Source by Income Quintile, SILC-2005



Source: Ireland, Department of Social and Family Affairs (2007, Table 4.4).

CONCLUSIONS FROM EVALUATION OF PUBLIC AND PRIVATE COMPONENTS OF THE PENSION SYSTEM

The evaluation of the public and private pension systems presented above in terms of simplicity, adequacy, cost, equity, coverage, efficiency, and sustainability leads to a number of conclusions. The public pension system is much simpler to operate than the private pension system. However, it has not eliminated pensioner poverty. The cost of Exchequer support for the private pension system is largely ignored in the Green Paper but the cost of the tax expenditure for private pensions is now as large as the cost of direct expenditure on the public system.

Most of the benefits of the pension tax reliefs have been appropriated by the very highest earners. This occurs at the expense of taxpayers generally who receive little benefit from the favourable tax treatment of private pensions. The introduction of ARFs in Ireland for the self-employed provides an example of how tax reliefs for the private pension system can be exploited to avoid paying any tax on retirement savings. The generous tax exemption limits for older people make it unlikely that when private pensions are paid to employees the Exchequer will recover much of the tax foregone on contributions and investment income.

The existence of generous tax reliefs for private pensions has not increased the coverage of occupational pensions. In fact, occupational pension coverage has fallen over the last twenty years or so and the composition of pension plans has shifted decisively in favour of defined contribution arrangements in which the employee is exposed to all of the investment risk.

The public pension system is far more effective than the private system in delivering pensions to the majority of pensioners and in providing the major part of retirement income. Only a small minority of pensioners at the top of the income distribution receive significant benefits from private pensions.

Despite the poor performance of the private pension system the Green Paper argues that maintaining the current public pension system and increasing the coverage of the private system in the future provide the best options for tackling pensioner poverty and improving the adequacy of pensions in the future. This would shift the balance of public/private provision in Ireland even more in favour of the private system.

Our evidence on the performance of the public and private components of the pension system over the last twenty years suggests that such a shift would be ill advised. Instead, the balance should shift in favour of the public system and the subsidies being provided for the private system should be significantly reduced and targeted at low- and middle-income earners.

OPTIONS FOR PENSION REFORM

Based on our analysis of the performance of the public and private components of the pension system there are two options which could achieve the goals of eliminating pensioner poverty and providing a sound basis for individuals to undertake saving for retirement during their working lives. These options show how the current system might be developed in ways that draw on the strengths of the public system and begin to correct the inequitable treatment of taxpayers who gain little from tax reliefs for private pensions.

The two options are:

- to eliminate pensioner poverty by increasing Social Welfare pensions and paying for the increase by reducing the subsidies for private pensions
- to introduce a universal State pension similar to the scheme which has been successfully operated in New Zealand for a long number of years

The first option differs from the option considered in the Green Paper in specifically recommending that the cost of the increases should be paid for by reducing the subsidies for private pensions rather than increasing the statutory retirement age or reducing other public expenditure. The second option develops a recommendation previously made by the Pension Policy Research Group by comparing the performance of Ireland and New Zealand's pension systems and showing that something similar to the New Zealand model could be adopted in Ireland at less cost to the Exchequer than the present pension arrangements (see Hughes, 2008).

Option 1: Increase Social Welfare Pensions and Reduce Pension Tax Incentives

Following a government commitment to improve pensions at the beginning of this decade, Social Welfare pensions in Ireland have slowly risen relative to average earnings. These improvements have brought Social Welfare pensions to a position where it would be possible to implement a policy of increasing them to a level that would virtually eliminate pensioner poverty. The Pension Policy Research Group believes that there should now be a significant increase in Social Welfare pensions which would be paid for by giving the tax relief on private pension saving at the standard rate of tax rather than at the marginal rate of income tax. Callan, Nolan and Walsh (2007) have costed this option and they show that it would more than cover the cost of virtually eliminating pensioner poverty without the necessity for a gradual increase in the statutory retirement age or reducing other public expenditure (the additional requirements considered in the Green Paper).

Option 2: Introduce a Universal State Pension Modelled on New Zealand Superannuation

On its own increasing the Social Welfare pension would not resolve the complications outlined in the Green Paper resulting from incomplete contribution records for the social insurance pension, the means test for the social assistance pension, rules about dependency, the retirement condition required for the State Pension (Transition), and the interaction of Social Welfare pensions with private pensions which creates uncertainty about how much to save and results in the loss of private pension benefits for low paid members of some occupational defined benefit pension schemes. For example, not everyone over pension age in Ireland receives a Social Welfare pension or qualifies for the maximum payment. About 70 per cent of all those aged 65 and over receive a social insurance or a social assistance pension while adult dependant pensions are paid for a

further 13 per cent (although not all of these are aged over 65). The remaining 17 per cent receive no Social Welfare pension either because they do not satisfy the contribution conditions or the means-test. [5]

Women in Ireland are particularly disadvantaged by the State and private pension systems because they provide most of the care required by children and elderly relatives. Consequently, their work histories are more irregular than those of men and it is more difficult for women to qualify for either a State or a private pension. This is an undesirable outcome of Ireland's work based system of public pension provision which treats those who fare well in the labour market better than those who do not.

In conjunction with a significant increase in pension levels Ireland should, therefore, also consider the option of introducing a universal State pension to eliminate the means test and differential payments to pensioners whose needs are the same, to provide security in retirement for about one-fifth of older people who currently are receiving no State pension, to address the problems which women in particular face in providing an income for old age, and to address the anomalies arising from lack of consistency between contributions paid and pensions awarded.

One of the few countries in the OECD which has had a universal State pension for many years is New Zealand. In view of the similarities between the pension systems in the two countries the Pension Policy Research Group has advocated that Ireland should learn from the New Zealand experience and seriously consider policies which would have the following elements (see McCashin, 2005; Stewart, 2005; and Hughes, 2007):

- a universal State pension
- a second tier social insurance pension based strictly on contributions which would top up the universal pension
- a significant curtailment of the tax incentives for occupational pensions, PRSAs, RACs and ARFs

Ireland is not, of course, starting with a clean slate. Pension systems are to some extent path dependent so it is not being suggested that Ireland should simply copy New Zealand's policies. What would be possible is to adopt a mix of policies which incorporates some ideas drawn from the New Zealand experience.

McCashin points out that this design "recognises the fact that a pensions system, of necessity, must incorporate a number of competing values, that reform must build to some extent on existing provisions and expectations, and command broad public support" (McCashin, 2005: 117). He argues that a universal pension funded out of general taxation would be distinctively redistributive, it would ensure pensions as of right for men and women, it would abolish the means-test for pensions but would retain a social insurance tier. The retention of the social insurance tier recognises the strong social and political attachment to work-based pensions in Ireland. In the framework proposed by McCashin (2005), the social insurance pension would not have dependants' additions. This would strengthen the role of social insurance as a benefit derived from participation

[5] The figures in this paragraph refer to those in receipt of transition, contributory and non-contributory State pensions (see footnote 2). When other State payments to those aged 65 and over are included 91 per cent of pensioner units receive some State benefits (see Figure 3.11).

in the labour force. The pension could be flat rate, as it is now, or it could be related to earnings.

At present Ireland is using social insurance pensions to try and achieve a number of different objectives: the prevention of poverty in old age, the provision of support for pensioners' dependants, the maintenance of contribution records during periods of unemployment, illness or temporary withdrawal from the labour force and the provision of adequate incomes during retirement. It is very difficult to achieve this multiplicity of objectives with just one instrument. The introduction of a universal pension would separate the goal of poverty prevention from that of income maintenance and permit the development of policies which would have a better chance of achieving each objective.

Such an approach to pension provision in Ireland would require the adoption of complementary policies which would increase Social Welfare pensions and pay for them by reducing the tax reliefs for private pensions. They could enable Ireland to eliminate pensioner poverty at a cost it could afford and at the same time contribute to the long-term sustainability of the public pension system. This approach also has the very considerable advantage that it is the only one which would improve the position of existing pensioners. Policies that rely on the private pension system to improve pensions will do nothing for existing pensioners as it requires a long period for assets to build up to a level that could provide even a modest improvement in living standards.

The proposal to introduce a universal pension and to reduce the tax reliefs for retirement saving are not as dramatic as they might seem at first sight (see McCashin, 2005). The State pension system is already providing the bulk of retirement income for the great majority of pensioners in Ireland. The tax reliefs for retirement saving have not succeeded in increasing coverage of occupational pension schemes and the tax incentives for personal pensions (PRSAs) have had little effect on coverage especially at the lower end of the income distribution. The combined cost of expenditure on the public pension system and the tax expenditure on the private pension system in Ireland is now as great as the cost of the universal pension system in New Zealand. In the future the combined cost of Exchequer support for the pension system is projected to exceed the projected cost of New Zealand Superannuation (see Hughes, 2008).

An important advantage of the proposed strategy is that it would provide a secure framework for people who wish to save to maintain a reasonable relationship between their income from work and their income in retirement. It would improve the living standards of current pensioners, contribute to the elimination of pensioner poverty, improve the equity of the tax system, provide equal treatment for men and women, and contribute to the long-term sustainability of Ireland's public pension system. Finally, it would strengthen the public pension system which is already nationally established, politically accountable and enjoys public credibility and legitimacy.

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