Ministers Speeches

Speech By

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to the

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Pensions Policy: Addressing Issues of Equity and Efficiency

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Minister Warns Almost Half The Country's Current Workforce Do Not Have An Occupational Or Personal Pension

Brennan says the scale and depth of the pension's problem Ireland faces cannot be overstated

Ministers Speeches

I am delighted to be here this morning to open this 21st Annual Conference of the Foundation for Fiscal Studies.

In particular, I would like to thank your Research Director Aedin Doris for inviting me to give the opening address.

In an Ireland of remarkable economic performance in recent years, the monitoring and close observations of the Foundation on how this is impacting on economic and social policy have been a valuable contribution.

I want to take this opportunity to salute the work of the Foundation and to state that the Government welcomes and encourages the contributions as part of the shaping of the Ireland of the 21st century

I need hardly remind you of what has been achieved in a relatively short period of time. Ireland is enjoying the longest and strongest era of sustained prosperity in all of our history.

In less than a decade, economic growth has averaged around 7 per cent per annum; unemployment has been reduced from over 10 per cent to historically low levels; over half a million new jobs have been created and long-term unemployment has been cut dramatically from 5.6 per cent of the labour force to just 1.4 per cent. In addition, the debt burden has been reduced from about 72 per cent of GDP to 28 per cent, thereby freeing up significant resources that would otherwise have been swallowed up by debt servicing.

In 2005, GDP growth was estimated at 4.6 per cent, with GNP growth of 4.8 per cent.

Since 1997 the Irish economy (GDP) grew by an average of around 7 per cent per annum. This was one of the best economic performances in the world and compares to an average of just 2 per cent in the Euro area. The labour market has performed very strongly, with employment growth of 4.7% in 2005.

In less than a decade the number of people employed in Ireland has increased by over 600,000. There are now nearly two million people employed in this country and unemployment today remains close to historically low levels.

Emigration, which for decades, if not centuries, drained this country of its youth, has been replaced by immigration. Ireland is a country in its stride, confident, articulate and brimming with ambition.

And yet, Ireland is also a country in which the buoyant economy and the surge of prosperity has not lifted all of our citizens. There remains those for whom, up to now at least, the ebb and flow of economic success failed to lift them away from social vulnerability and existence on the margins of society.

Righting that unacceptable imbalance is one of the biggest challenges we face over the next few years. In this regard pensions come into clear focus. Everyone in this country should be entitled to a decent pension and to security and dignity in their later years.

However, as I have said before, there is a certain amount of complacency in our society regarding the pensions question and while optimistic economic forecasts, such as we have seen in the last week or so, are very welcome they do fuel this complacency and make it more difficult to get people to focus on the challenges ahead.

I am pleased that pensions are now very firmly on the national agenda-something that is reflected in the decision of your conference to devote a considerable amount of time to future pensions policy.

The reality is that there can be no doubt that one of the most important policy challenges facing this country, and this generation and future generations, is the foundations for the future retirement in security, and with dignity, of all of our people. There are no quick-fix solutions to the fact that right now almost half the country's current workforce of 2 million people do not have any occupational or personal pensions.

Ireland is not unique in having a looming pensions problem. All around the world governments and societies are grappling with the impending crisis of a lopsided population structure in which older people far outnumber younger workers. Ireland's response to the challenges and opportunities posed by this rapid social, economic and demographic change will influence the future shape of our society for decades to come.

The scale and depth of the pension's problem Ireland faces cannot be overstated.

At present over 900,000 people, almost half the country's entire workforce, do not have any private pensions and, as of now, are facing into a retirement in which their main source of income will be the State welfare pension. At least half of these are women. While we are committed to maintaining the very substantial improvements in welfare pensions made in recent years, the reality is that many of those relying exclusively on these pensions will continue to have a high risk of poverty.

The number of people aged over 65 will more than treble from a current level of about 464,000 to 1,500,000 by 2056.

At present there are over 4 workers contributing to the support of every pensioner. This will fall to 2.7 in 2026 and to less than 1.5 workers per pensioner in 50 years time.

The cost of our social welfare and state pension system will, according to work done in the context of the National Pensions Review, increase over the same period from 4.3% of GNP to 13.8%. This forecast of increasing costs is far ahead of any estimates done to date. Not only are the projected costs higher than we have anticipated until now, but they also bring us very close to the cost projections for 2050 for the rest of the EU. Until now we have seen ourselves as being in a much better position than our neighbours, both in the short and long-term.

Just 33% of existing pensioners have income from an occupational or private pension. Our coverage figures for the current workforce would suggest that this will improve over time but we are still a long way short of the sort of coverage rates that everyone is agreed are required.

At present the pensions system replaces 51% of pre-retirement income for couples and 43% for single pensioners.

So the challenges we face are clear and stark. We must tackle the serious lack of adequate pension coverage rates, the overall adequacy of pensions and the major issues of funding or sustainability of pensions.

Before dealing with the long-term situation and how we are proceeding I would like to say a few words about adequacy and funding as I think these are inter-related.

Thankfully, we have not seen the wholesale closure of defined benefit schemes that has occurred in the UK. Nevertheless, defined contribution has become the dominant model when we are looking at new schemes.

The fact that employers are continuing to invest in pensions is welcome but, of course, we would all prefer to see the defined benefit model maintained and prospering as, in my view, it offers the best guarantee of a decent pension at retirement. Defined contribution schemes transfer the investment risk to the employee and there are also concerns about the adequacy of contributions being made to such schemes.

While we have little to go on in terms of outcomes for people in this type of scheme, based on the contributions being made, we do have concerns at the level of pension, which will accrue to people at retirement. People must be realistic in relation to the contributions they make to their scheme and what they expect to receive when they retire.

The Funding Standard and new accounting requirements, which makes pension costs very apparent on a firm's balance sheet, are put forward as the two main reasons for the drift from defined benefit provision. In relation to the Funding Standard this attempts to draw a reasonable balance between the interests of employers and the legitimate expectations of employees to be guaranteed their pension.

This is very difficult balance to achieve, and although the system was fully reviewed in 2003, it is not clear that we have struck the right balance. Despite resurgent markets schemes are continuing to fail the Funding Standard and there is pressure on employers to make higher contributions to their schemes to make up the shortfall.

Some would argue that because of the short-term focus of the Funding Standard, which requires a scheme to maintain assets to cover a wind-up at any time, the cost of pensions is kept artificially high and that this is driving employers out of the defined benefit model.

While in the normal course of events I would be reluctant to open an issue so soon after a major review, the arguments in favour of another look at the situation are compelling. Accordingly, I have asked the Pensions Board to revisit the question to see to what extent we can deal with the issues we are seeing.

Our main focus has, for a number of years, been on coverage, with efforts being made through the introduction of PRSAs and an extensive awareness campaign to boost participation rates. Overall numbers with pensions have increased, but in terms of our coverage target of 70% for those over 30 years of age, only limited progress is being made.

At this stage, I think we have reached a cross roads in terms of our pensions system and the choices we make now will have wide-ranging effects for generations to come. As Anne Maher will tell you later a majority of the Pensions Board, as of now, favours a continuation of the existing voluntary system with improved SSIA type incentives.

I have no doubt that this could make a contribution to improving our position. However, no truly voluntary system, that I am aware of, has delivered the type of supplementary pensions cover we are seeking. Accordingly, I believe we must at least consider a more radical approach, including some type of mandatory, or soft mandatory, provision.

The Pensions Board has already done some work in the area of mandatory pensions and outlined, in a general way, the cost and other implications of a range of models including mandatory and quasi-mandatory provision.

The existing system of tax supported private pensions has often been criticised because it favours the higher paid and because it takes from the resources available to pay State pensions. The tax foregone at some €2.5 billion annually is roughly equivalent to the resources devoted to existing expenditure on the State contributory and non-contributory.

One view is that investing the €2.5 billion in greatly improving the position of existing pensioners would be a more effective use of resources.

However, if we look behind the basic figures, we see that there are significant problems with the logic of this approach. Firstly, the Exchequer cost of social welfare expenditure in any year is overstated since it does not take account of PRSI contributions, which people have made.

Secondly, the cost of tax relief is overstated because it does not take account of the tax, which will be paid on future pension income, though we would all accept that the receipts will not match the tax foregone on pension savings. Also, you could not count on the tax foregone on investment income as this may not be available because there is no guarantee that investments would have been made had the savings not been incentivised.

Social welfare pensions cost about 3% of GNP at present with tax relief on pension contributions by workers and employers amounting to 1.1%. Abolishing tax relief would, therefore, enable social welfare pensions to be increased by 37%, an attractive proposition for any politician.

However, as we look forward to 2056, we find that the cost of social welfare pensions will increase to about 10% of GNP and the percentage foregone in tax relief remains more or less the same. In that scenario the scope for pension increases is only 13%, which would leave us in a very difficult position with difficult choices to make.

The short-term benefit of increasing pensions by 37% is probably not sustainable in the long-run because of the changing relationship between pensions costs and resources available from abolishing tax incentives. In the circumstances, we would probably need to taper off pension rates at some stage in the future in a scenario where the supplementary pension system is probably much weaker as a result of our decision to abolish tax incentives for pensions savings. That could have a significant impact on the income of future pensioners.

I have no doubt that there are those here today who would disagree with this analysis and the very reason I raise it is to progress the debate and examination. I should also stress at this stage that I am not advocating any particular course of action though, as I have already said, I do think that we may need to take a radical approach if we are to address the issues we face.

However, whether you agree or disagree with the analysis, I think it gives a good flavour of the type of debate we as a society need to have in the coming months as we come to grips with the issues concerning pensions and how we will address them. There is no perfect solution.

For example, I am examining closely the Pensions Board proposal to allow people to defer taking social welfare pension at age 65 in favour of having it increased on an actuarial basis at a later date.

Also, the new incentives announced recently by the Minister for Finance on SSIAs is a very positive development and will help us to capture some of the savings in these accounts and consolidate them into long-term pensions savings.

The SSIA system has started a savings habit for many thousands of people and, hopefully, the incentives being offered will see this maintained.

However, in the final analysis, we need a long-term sustainable solution to the challenges we face. In that context, I have asked the Chairman of The Pensions Board. Tiarnan O Mahony, to undertake an urgent examination and costed analysis with his board of the options regarding a mandatory, or quasi-mandatory, pensions system.

At the end of the day, we must decide what sort of retirement we want for ourselves and our children and what sacrifices we as a society are prepared to make to secure that future. Good pension provision costs, whether it is done through a system of private provision and personal contributions or through the State by way of taxes and social insurance contributions.

Conferences such as this can make a significant contribution to furthering this debate and I look forward to hearing reports of the contributions from Brian Duncan, Dermot McAleese, John Martin and Shane Whelan.

For my part, I feel it is important at this stage to hear the views of the various stakeholders on the way forward and, accordingly, I am convening the National Forum on the 5th May to hear the views of unions, employers, pension providers and pensioner representatives on the conclusions of the National Pensions Review and on how we should move forward. I hope the day will be informative and thought provoking and that it will assist me in deciding on a course of action which can achieve our goals in this crucial area and which can command broad acceptance.

As I said earlier, all around the world countries are confronted by the same pensions challenge. That challenge is to confront the issues and to design and deliver a pension system that is in touch with and responsive to rapid changes in society and the aspirations of its people.

I think it is no exaggeration to say that our response to the challenges and opportunities posed by rapid social, economic and demographic change will influence the future shape of our society for decades to come.

Finally, I would like to wish you an enjoyable and productive morning and to compliment the Foundation on the appropriateness and timeliness of the topic it has chosen to explore today.

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