CHAPTER 01

THE CURRENT SYSTEM AND ITS OVERALL PHILOSOPHY
Introduction

1.1 This Green Paper on Pensions is published in fulfilment of the commitment in the social partnership agreement, ‘Towards 2016’. The publication of the Green Paper follows a period of increased activity in the development of pensions policy which has seen the publication of two major reports by the Pensions Board - the ‘National Pensions Review’ (2006) and ‘Special Savings for Retirement’ (2006). These two reports built on the earlier report of the Board on the National Pensions Policy Initiative (NPPI), published in 1998. This Green Paper takes account of all of these reports and, using the most up-to-date data, sets out the key issues and challenges now facing the Irish pensions system.

1.2 The publication of the Green Paper will be followed by a period of consultation. Through this process, the Government will seek the views of all stakeholders, with a view to developing a framework for comprehensively addressing the pensions agenda over the longer-term.

1.3 This opening chapter sets out the main elements of the Irish pension system, the objectives and philosophy which underpin it, the challenges it faces and the type of reforms undertaken in other countries in recent years in response to the challenges facing their national pension systems.

1.4 Following a discussion on demographic projections in Chapter 2, the sustainability of the present system is discussed in Chapter 3. Chapter 4 examines the adequacy of Social Welfare and supplementary pensions. An extended discussion of current issues on Social Welfare pensions is contained in Chapters 5 and 6. Chapter 7 discusses incentives for retirement saving. Chapter 8 looks at some possible approaches to pensions development. The following chapters examine defined benefit and defined contribution schemes, the funding standard, annuities, the role of regulation and public sector pensions respectively. Work flexibility and retirement age, issues that cut across various themes in this Green Paper, are discussed in the final chapter. A short summary is given at the end of each chapter together with questions for consideration for Chapters 6 to 14.

The pensions system in Ireland

1.5 The pensions system in Ireland comprises two main elements. The first is the state-run Social Welfare system and the second comprises voluntary supplementary pensions provided through a variety of arrangements and regulated by the State. These take the form of pensions sponsored by the employer, or personal pensions such as Retirement Annuity Contracts (RACs) and Personal Retirement Savings Accounts (PRSAs). The overall objective of our pensions system is to provide an adequate basic standard of living through direct state supports and to encourage people to make supplementary pension provision for themselves so that they may have an adequate income on retirement.

Social Welfare System

1.6 The pensions provided under the Social Welfare system are intended to provide an adequate basic standard of living. They comprise flat-rate payments with eligibility based on achieving a certain level of social insurance contributions over a person’s working life (State Pension (Contributory)) or through satisfying a means test (State Pension (Non-Contributory)). Means-tested payments are funded entirely through taxation. Payments based on social insurance contributions are funded through pay-related contributions made to the Social Insurance Fund by employers, employees and the self-employed with subvention, where necessary, by the State. Those who are unable to contribute because of unemployment or illness are, subject to conditions, credited with contributions, while arrangements are also in place since 1994 to protect the pension entitlements of those who spend time out of the workforce on caring duties.

1.7 Social Welfare pensions can also include additional allowances for dependants, those living alone and those over 80 years of age. Supplements are also provided to assist in meeting the costs of electricity, fuel in the winter months, telephone rental and a television licence. All persons aged 66 and over are entitled to free travel on public transport while the other benefits, except the fuel allowance, are available on a universal basis to those over 70 years of age. The current (January 2007)
weekly rates of payment are €209.30 for the full-rate State Pension (Contributory) and €200 for the State Pension (Non-Contributory).

1.8 Means-testing remains an important, but declining, feature of Social Welfare pensions. In the 20 years from 1974, a number of significant changes were made to the social insurance system - with coverage extended to groups such as the self-employed, part-time workers and new public servants. These changes are now feeding through to the Social Welfare pensions system, with more people qualifying for pensions on the basis of their social insurance record rather than on the basis of a means test.

Voluntary Supplementary Pensions

1.9 Voluntary supplementary pensions account for approximately one quarter of overall income in retirement. Due to the immaturity of the system, however, this is expected to increase. The role of voluntary supplementary pensions in the Irish system is generally, to encourage people to make supplementary pension arrangements to ensure that income in retirement is related to the income received by them when they were employed. Pensions can be provided through a person's employment or directly through financial institutions acting as pension providers. Employers are not obliged to provide occupational pension schemes for their employees, but many do so, and where an employee does not have access to an occupational pension scheme or where one does not exist, the employer must enable his or her employees to access a Personal Retirement Savings Account (PRSA).

1.10 The State encourages and promotes membership of occupational and personal pension schemes through favourable tax treatment and regulation to safeguard entitlements in so far as possible. The tax approach is EET (exempting contributions, exempting fund growth but benefits are taxable). Payment of tax (and PRSI and Health Levy) is exempted on contributions to such schemes within certain limits. Investment returns on the contributions are also exempt from taxation at the point when they are earned. However, with certain exceptions, income drawn down from such schemes is taxed under the normal tax rules at the time of drawdown. This deferral of taxation, together with the fact that, for many individuals, a combination of lower retirement income (and therefore lower income tax), more favourable rates for older people, and the promise which exists for a tax-free lump sum payment or the opportunity for some to further defer tax through an Approved Retirement Fund (ARF) structure (to be described later) mean that, in practice, an EET system is operated in a way which provides a considerable tax incentive for pension provision, depending on personal circumstances.

Objectives of the pensions system

1.11 The overall objective of the pensions system, as outlined above, is to ensure that people have an adequate income in retirement. In relation to Social Welfare pensions, the objective is to provide income and other supports so that pensioners are assured of an adequate basic standard of living. The role of voluntary supplementary pension arrangements is to encourage people to make supplementary pension provision. In this respect, a private pension may supplement the Social Welfare pension as well as other forms of retirement income.

1.12 In preparing the annual Budget, the Government considers what increases can be provided in Social Welfare pensions in the light of its social policy commitments and the resources it has available to meet pensioners' needs and the other competing demands for public expenditure. A number of different approaches have been proposed by advisory bodies about appropriate targets for Social Welfare and other pensions. For example, the National Pensions Policy Initiative (NPPI) (1998) considered that a target rate of 34% of gross average industrial earnings (GAIE) was an appropriate benchmark for Social Welfare pensions. It also suggested that, for Social Welfare pension and supplementary pension combined, 50% of pre-retirement gross earnings was an appropriate level. After reviewing the position, the Pensions Board’s ‘National Pensions Review’ (NPR), published in 2006, indicated that these benchmarks
should continue to be taken into account by Government in the implementation of its policy. The State Pension (Contributory) now stands at approximately 35% of GAIE, following significant increases in Social Welfare pensions in recent years. The NPR also recommended the continuation as an ultimate target (to be achieved some time after 2013) that 70% of the working population over 30 should have a supplementary pension. Pension coverage for this group is now 61.8% (QNHS, Quarter 4, 2005), up from 58% in 2002.

1.13 The objectives of the EU Open Method of Co-ordination (OMC) in a number of social policy areas form another useful input in the context of setting objectives for the pension system. The OMC pensions objectives of adequacy, sustainability and modernisation are also key objectives of our national pension system. These three objectives are interdependent. For example, in considering increasing pension levels, it is necessary to have regard to issues of sustainability. In addition, in the context of modernisation of the pension system, it is important to ensure that changes made do not impact negatively on the adequacy of pension provision. These three broad objectives, common to all EU Member States, constitute a suitable framework to consider the many issues that arise in Irish pension reform, and are discussed briefly now and, in more detail, in later chapters.

Adequacy
1.14 It is an objective of the Social Welfare pension system to provide income and other supports at an adequate level. Pension adequacy is also about the maintenance of a level of retirement income which is adequately related to pre-retirement income. Recent Social Welfare pension increases have brought both the non-contributory and contributory pensions to and above a €200 per week target set by Government.

1.15 In relation to supplementary pensions, the National Pensions Review (2006) identified a number of adequacy issues. Firstly, it outlined the view that defined benefit schemes will tend to offer higher pensions to individuals that remain with the same employer. Also, low contribution levels in defined contribution schemes are likely to result in relatively low replacement rates. Typical contribution levels, and anecdotal evidence, suggest that contributions to PRSAs and Retirement Annuity Contracts (RACs) are proportionately less than contributions for occupational pension schemes. Finally, about one third of occupational pension schemes provide for guaranteed increases of pensions in payment - so the value of other arrangements may be eroded through inflation. The adequacy of Social Welfare and supplementary pensions is discussed in detail in Chapter 4.

Sustainability
1.16 In common with many other countries, Ireland is experiencing demographic changes which increasingly, over time, will add considerably to the cost of pension provision. In the case of the Exchequer, these pressures will be reinforced by the impact of an ageing population on health expenditures. Assessments by international organisations have shown that many countries, including Ireland, will, in the absence of countervailing factors, face widening budget deficits and rising levels of public debt as a result of age-related expenditures of which pension provision is the single largest component. Therefore, along with the focus on adequate income in retirement, a key objective of our pension system is sustainability. In a situation where people are, happily, living longer, the sustainability of our system becomes an issue of even greater concern in that we need to consider efficient ways of ensuring that older people are adequately provided for throughout their retirement. It is inevitable that the proportion of people aged over 65 will increase rapidly compared to the proportion at work in the coming decades. Projections in the National Pensions Review indicated that pension costs impacting on the Exchequer will already show a noticeable increase by 2016. Projections by international organisations indicate that this trend will accelerate in the following decades. Clearly, the changing composition of the population will pose significant challenges for the economy and the public finances, with implications for the long-term sustainability of the pension system.

1.17 Several options for reform are suggested in this Green Paper with a view to ensuring the long-term sustainability of pension provision. As well as financial and economic sustainability, we
also need to have regard to social sustainability which covers issues such as inter-generational solidarity and expectations around future living standards.

1.18 Ensuring sustainability will require an appraisal of existing policies. Increasing the size of the labour force (particularly in terms of increasing participation rates for groups currently under-represented, including older workers), increasing pension coverage, improving the economy’s productive capacity and overall competitiveness, providing a sound regulatory environment, reform of the social insurance system and the establishment of the National Pensions Reserve Fund are channels through which Ireland is already addressing sustainability issues. Financial sustainability is also an issue for supplementary defined benefit pensions. Increasing longevity is causing a continuing increase in the cost of benefits, and risk awareness and asset volatility is causing some employers to re-examine their sponsorship of such schemes. Sustainability is discussed in detail in Chapter 3 while specific issues related to defined benefit schemes are discussed in Chapter 9.

Modernisation

1.19 In order to provide adequate pensions and to remain sustainable, a pensions system must, for example, move in tandem with changes in the labour market and facilitate people who move jobs or adopt more flexible working patterns. This has particular implications for women who currently tend to avail of more flexible working arrangements than men.

1.20 Modernisation of the Irish pensions system is an ongoing process. In recent years, significant changes have been made to the system in an attempt to adapt pensions to a changing economy, society and labour market. The introduction of PRSAs, changes in qualifying conditions for Social Welfare pensions, increased provision for protection of supplementary pension entitlements, the establishment of the Pensions Ombudsman, the implementation of equal treatment legislation in the pensions area and the significant discussions brought about through the National Pensions Review have all contributed to this process.

1.21 The issue of equality of treatment between women and men is crucial. A modern system must provide equal access to men and women. This Green Paper discusses issues that are of particular relevance to gender equality. In particular, the issue of women’s eligibility for social insurance pensions is discussed, and how periods of care outside of the labour force might be recognised in the social insurance system (see Chapters 5 and 6). In addition, the relatively low proportion of women in supplementary pension coverage is examined (see Chapter 4).

An evolving system

1.22 While the delivery of a pensions system is closely dependent on economic, social and financial factors, political, philosophical and cultural values also play a part in people’s attitudes and demands. Typically, there may be fundamentally differing views on the respective roles and obligations of the individual, the employer and the State in pensions delivery.

1.23 In this context, Ireland has witnessed a growing debate on pension provision over the last decade. Policy development, on foot of projected demographic change, has been ongoing since the mid-1990s. The future development of pensions policy is central to the development of economic and social policy in Ireland. Over successive social partnership agreements, there has been a growing focus on pensions - culminating in the commitment in ‘Towards 2016’ to produce this Green Paper - leading ultimately to the publication of a Government framework for comprehensively addressing the pensions agenda over the longer-term.

1.24 The issues are also particularly topical due to the real, very practical challenges that have arisen for employers, employees, pensioners and Government itself (as both Government and employer). The challenges are similar to those in other countries and arise from demographic change, the rising cost of pensions, and investment and financial risk.

1.25 In keeping with international trends, virtually all of the pension schemes which have been put in place in the private sector in Ireland over the
past 15 years have been defined contribution. In addition, some pre-existing schemes have changed from defined benefit to defined contribution. (It should be noted, however, that the total membership of defined benefit schemes is remaining steady - although defined benefit membership as a proportion of total pension scheme membership is declining.) As a result of the decisions being made to close or alter defined benefit schemes, there may now be a greater awareness among employees generally as to their pension situation and the type of pension scheme to which they belong (defined contribution or defined benefit). They may also be more conscious of the respective advantages and disadvantages of different types of pension arrangements.

1.26 Pension provision by Government has involved Social Welfare pensions, which have been significantly increased in recent years, and support for the voluntary supplementary system. While the cost of pensions will rise, achieving a fair and proportionate sharing of the cost - which takes account of the need to secure future growth of the economy - is the fundamental challenge facing the Irish pensions system.

1.27 The current pensions system in Ireland can be described as a tripartite arrangement between the State, employers and individuals/employees/self-employed. This tripartite arrangement applies, in different ways, to both first pillar (Social Welfare) and second pillar (occupational) pensions.

First Pillar Pensions - the tripartite arrangement

1.28 First pillar pensions in Ireland consist of two types of payment - non-contributory and contributory. The State Pension (Non-Contributory) is financed through general taxation and is paid according to need. It is a means-tested payment, paid from 66 years of age. The State Pension (Contributory), however, is paid to those people over the age of 66 years who have made sufficient social insurance contributions. The Social Insurance Fund, from which contributory payments are drawn, is funded by employers, the self-employed and employees, with subvention from the Exchequer where necessary.

Second Pillar Pensions - the tripartite arrangement

1.29 Second pillar pensions follow a different arrangement, whereby the State, employers, self-employed and employees are involved in a mutually beneficial (but voluntary) system. An employer, for example, may provide an occupational pension scheme for its employees as part of a remuneration package. Contributions made by both employees and employers receive tax relief at the appropriate rate (provided by the State through tax foregone) which is designed to encourage take-up of, and contributions to, such occupational pension schemes. Pension fund investments are also exempt from tax on their capital gains and income. This arrangement is designed to assist in achieving the State’s objective to encourage individuals to provide adequate replacement income by encouraging employees and the self-employed to contribute to funding their own pensions. In addition, the adequacy of such arrangements is enhanced through financial incentives for employers to contribute. (See Chapter 7 for a discussion on financial incentives.)

1.30 In addition, the State provides a regulatory structure for second pillar pensions through primary and secondary legislation. The function of such regulation is to protect the integrity of the pension system, including the protection of the interests of members and the protection of pension schemes generally. In addition, the Pensions Board and the Pensions Ombudsman seek, respectively, to ensure compliance with the Pensions Act 1990, and to resolve complaints and disputes in relation to occupational pension schemes and PRSAs. The Financial Regulator also has a part to play in relation to consumer protection and overall issues of solvency of providers.

Role of the State

1.31 In relation to Social Welfare pensions, the traditional role of the State has been to provide income and other supports so that pensioners are assured of an adequate basic standard of living. (A Government commitment to provide pensions of at least €200 per week was achieved in Budget 2007.) An alternative view, however, is that Social Welfare pensions should provide for
more than this, that is, that they should provide for an income in retirement that reflects a higher share of the economy’s resources. In this context, some argue that the role of the State should be to provide pensions that are well above the ‘risk of poverty’ line, are set at a higher level of gross average industrial earnings (e.g. 40% or 50%) and uprated in line with that, or are set at a higher monetary level. Essentially, the argument is that state resources should be redirected from other purposes towards higher levels of pension provision, that additional taxation should be raised for this purpose, or that other policy measures are put in place to ensure the increase is sustainable. These options are discussed in Chapters 6 and 8.

1.32 Others see an even greater role for the State in providing Social Welfare pensions, suggesting that pensions should not be means-tested or based on social insurance contributions, but rather paid to all people reaching retirement age as a right of residence or citizenship. This issue is discussed in Chapter 6.

1.33 However, raising the level of Social Welfare pensions (in the absence of other reform), raises major sustainability considerations, due in particular, to the ageing population - where the proportion of those at work compared to those over 65 years of age will see a dramatic reduction in the coming decades. This will significantly increase the cost of Social Welfare pensions. The cost of public service pensions will also rise significantly over this period. The cost of both Social Welfare and public service pensions will be met only in part by the National Pensions Reserve Fund. Therefore, the sustainability of making substantial additional pension promises to future generations of older persons must be considered in the context of a general expectation that, relatively speaking, there may be less taxpayers then to finance these promises. Moreover, any such pensions will fall to be paid at a time when other age-related expenditures - such as health - will also be much increased.

1.34 In reaching its pension objectives, the State needs to strike a balance between maintaining economic growth and stability, social cohesion, and raising resources to meet growing, long-term pension liabilities. There are certain things that the State can do to meet increasing demographically-related liabilities, including pensions - such as increasing taxes or PRSI contributions, introducing measures to extend working lives, reallocating resources from other areas of public expenditure and introducing measures to increase take-up and the level of pension contributions - but any decisions made need to have regard to the effects that they may have on other areas of the economy and society. The Government notes, in this regard, that environmental, social and corporate governance issues are taken into account in the implementation of the National Pension Reserve Fund’s statutory investment policy. The pension issue must be seen in its broad economic and social context.

1.35 The State’s role should also extend to providing for the current generation of pensioners as well as the pensioners of the future. The wider population also has needs which carry resource implications. There are complex issues of social sustainability and inter-generational equity to be considered in striking the right balance between these needs and those of future generations. This will require a balance to be struck between social sustainability (for example, solidarity between generations) and economic sustainability.

1.36 Supplementary pensions are taken out by individuals to provide adequate income in retirement. Supplementary pensions are also closely aligned with the State’s economic objectives of sustainable economic and employment growth and improved competitiveness. Fostering a successful supplementary pensions environment assists in creating financial stability and wealth creation and provides a basis for retirement income beyond a reliance on State support.

1.37 The future role which the State may play in supplementary pensions is also discussed in this Green Paper. As a facilitator of supplementary pension provision through financial incentives, are the means through which the State strives to increase coverage rates and encourage adequate provision the most efficient and effective? Should the State provide incentives in a different way, for example (see Chapter 7)? What regulatory role should
the State play in the supplementary pension system (see Chapter 12) and would a mandatory or soft mandatory supplementary pension route be a more effective way of achieving objectives (see Chapters 7 and 8)? What is the role of the State in encouraging take up and the provision of information and support, including to trustees (see Chapter 12)?

1.38 It may be considered that the State’s role in supplementary pensions should not radically change, that it should continue to provide incentives to encourage pension provision and also ensure consumer protection. Others will argue that the State should adopt a more directive role, intervening in a market that, as they see it, has failed, and requires greater State intervention to ensure that people save for the long-term and that their savings are secure. The discussion in this Green Paper, and the subsequent consultation process, will be designed to further this debate.

1.39 As stated, the impact of choices in the pensions area must also be assessed by reference to the other functions of the State, including those relating to maintaining economic growth and social cohesion. State intervention is only one potential means through which to achieve a sustainable pensions system. The respective roles of both the employer and the employee/individual are crucial to the success of any pension reforms.

Role of the employer

1.40 Many employers have provided workers with pension opportunities through occupational pension schemes and, since 2003, employers are obliged to provide access to a PRSA where an occupational pension scheme is not an option. Under a voluntary system, an employer may decide whether or not to put an occupational pension scheme in place, or may alter the terms of an arrangement already in place. In this regard, the employer is a key actor in defining the shape of work-based pension provision.

1.41 The two standard types of occupational pension scheme offered by employers in Ireland are defined benefit and defined contribution schemes. Defined benefit schemes generally offer a pension ‘promise’ (usually taking account of the Social Welfare pension) of a certain percentage of an employee’s final salary, while defined contribution schemes provide the employee with an amount determined by the level of contributions paid into a fund, its investment performance and the charges levied. For employers, there is a greater level of risk associated with defined benefit schemes in as much as the employer generally makes up any shortfall in the performance of the pension fund. While, in the past, defined benefit schemes were more the norm in employments which offered a pension scheme, various issues associated with such schemes have contributed to a significant decline in the share of the workforce covered by such schemes, with virtually all new private sector schemes being established as defined contribution. In this scenario, the investment risk associated with pension provision is shifted from the employer to the employee.

1.42 Defined benefit provision provides a degree of certainty and security for workers and retirees that post-retirement income will be related to their earnings. However, increasing pension costs can impact negatively upon firm competitiveness. These issues lie at the heart of the debate about pension reform and are addressed throughout this document, but particularly in Chapter 9. In that chapter, particular issues related to defined benefit and defined contribution schemes and how scheme design impacts on employers and employees are discussed. The State, as an employer, also has responsibilities to its employees in this regard, and public sector pensions are discussed in Chapter 13. In considering these issues, the appropriate future role of the employer in pension provision has to be addressed. For example, what responsibilities does an employer have to his or her employees when decisions need to be made about the type of pension scheme and benefits offered? And does provision of a good pension scheme provide advantages to employers?

1 In 1999, there were 145,000 members of defined contribution schemes and 425,000 members of defined benefit schemes (half of whom were in the non-commercial public sector). By 2005, there were 235,000 members of defined contribution schemes, and 500,000 members of defined benefit schemes (again approximately half of whom were in the non-commercial public sector).
1.43 In seeking a new direction on pensions, the additional costs that pensions may place upon employers must be recognised, as must the competitive advantages that may be afforded employers through their providing quality pension provision. For example, good quality pensions can attract and retain employees and can lead to an employer being seen as an ‘employer of choice’. In addition, a role may exist for employers and others in encouraging financial awareness among workers and in encouraging older workers to remain in the workforce (Chapter 14).

1.44 One of the key questions is who should bear the risk of pension provision in the future, or at least how that risk should be shared between employee, employer and the State, and between generations. The next section focuses on the role of the employee.

Role of the employee/individual

1.45 It is generally accepted that individuals should take responsibility for providing a retirement income by saving during their working lives. The level of responsibility that a person is willing or able to take may be related to age, their experiences, their values, the type of employment, their appetite for risk and their understanding of the issues involved in retirement provision. While one employee might be happy to engage with these issues, another might prefer the employer to decide the components of the remuneration package. It is generally accepted that supplementary pensions, while simple in concept or objective, are often complex in design, maintenance and delivery. There is also now an awareness of the lack of certainty regarding the precise level of benefit delivered at retirement. The challenge for an individual in understanding all of the various issues involved has to be kept in mind.

1.46 In this context, it should also be recognised that the decisions taken by today’s employees, and any costs associated with such decisions, will have an effect on the employees of tomorrow who will need to support an increasing number of pensioners. Research suggests that, due to what can be termed financial myopia, some people must be incentivised if they are to increase savings for their long-term future. (It should also be noted, however, that many individuals have taken out their own pensions under the current incentive regime.) While tax reliefs at the marginal rate are in place for individuals, increased awareness of the value of such reliefs may assist in overcoming the inertia that frequently works against an individual’s decision to save for his or her future. The success of the SSIA initiative shows that people will save when there are clear and understandable incentives for them to do so. One option that could be considered is to seek to replicate the success of the SSIA initiative in the context of the pension system by examining options for changing the current system of pension incentives (see Chapter 7).

1.47 When saving in pensions, however, people need to be confident that they are getting good value for money. While people are themselves bearing the investment risk under defined contribution arrangements, as compared to defined benefit schemes, any supplementary pension arrangements must be underpinned by a regulatory regime that protects their interests while maintaining a proportionate regulatory burden upon employers and commercial pension providers. It should also be noted that defined benefit arrangements have their own risks, including, for example, the possibility of losing a large part of accrued benefits. (The role of regulation is discussed in Chapter 12. People are also concerned about the effect of charging structures on the performance of their investment funds and this issue is also discussed in that chapter.)

1.48 While incentives and work-based provision can go some way towards encouraging such saving, there is also a view that individuals should be obliged to provide for their own futures. For many retirees, a Social Welfare pension may not be enough to provide an income appropriately related to their pre-retirement standard of living. If the view prevails that individuals should be obliged to provide for themselves, there are several options that can be taken. One is that the Social Welfare pension should be set at a certain minimum level and, beyond that, individuals should be able to make their own additional provision for retirement. At the other end of the spectrum, individuals might be compelled,
through a mandatory supplementary pension system, to provide for themselves beyond the basic Social Welfare pension. In view of the increased pension costs facing most developed countries, such an approach could be considered as one of the possible policy options. A key requirement in considering a move towards mandatory savings would be the need to ensure that the system would not undermine economic and financial sustainability and that it would meet the income needs of retired people. These and other options are discussed in detail in Chapter 8.

International Reform

1.49 It is useful to look at international developments and how countries - whose populations have aged earlier than ours - have adapted to the new demographic context. The main elements of our pension system - Social Welfare pensions provided by the State, occupational pensions provided through employers, and private pensions arranged by individuals through insurance companies and other financial institutions - are generally found in other developed countries. The size and relative importance of each element is determined by the manner in which each country has decided to deliver the greater part of retirement income for older people. A number of countries, for example, have some type of general state-sponsored pension with a formal link to earnings. It should be noted, however, that while other countries can offer us interesting and useful examples, their reforms are often unique to the social, economic and political context and are designed to address different challenges. There is no common one-size-fits-all solution to the funding of future pensions.

1.50 In many parts of Europe, there has been, broadly speaking, an earnings-related pension operated on a pay as you go basis through state social insurance systems, with private and occupational provision playing a relatively minor part. In other places, notably Australia, Chile and Singapore, a mandatory system of individual defined contribution accounts operates through social security or the private sector, sometimes supplemented by means-tested benefits where pensions fall below a minimum threshold.

1.51 Over the years, effective retirement ages have declined in many countries across the developed world, the age at which people enter the labour-market has increased and, at the same time, life expectancy after retirement has improved significantly. In short, contribution years have decreased while years in receipt of benefits have increased, putting pressure on the financing of pensions systems.²

1.52 The nature of reforms being undertaken varies from country to country but generally include some or all of the following measures:

- Disincentives to work longer have been reduced and, in some cases, positive incentives have been provided;
- In some cases, normal retirement age is being raised;
- The link between the contributions made and the benefits paid has been strengthened by, in some cases, increasing the number of years a person must contribute in order to qualify for full pensions. (In the UK, however, as part of an overall package of pension reform covering first and second pillar provision, the requirement for a basic state pension is being lowered from 40 to 30 years);
- Income replacement rates from State systems are being reduced over time and in parallel with promoting the provision of supplementary pensions;
- There is a tendency to use more defined contribution type arrangements in the public sector;
- Account is being taken of increasing life expectancy in setting the level of State pensions.

1.53 The driver of pension reform in other countries, particularly in Europe, is, primarily, sustainability rather than adequacy. Adequacy of pensions is not seen as a current issue in other European countries due to their relatively high level of payments. In Ireland, up to now, our focus has been on maintaining sustainability and increasing adequacy. For people who have spent a full career on average earnings, for example, the average gross replacement rate of earnings provided by a pension in OECD countries is 57% of pre-retirement earnings.

By contrast, Ireland has the lowest replacement rate at average earnings of 30.6%.

Appendix A provides examples of how pensions systems are organised in different countries. Generally speaking, these examples are intended to illustrate the different types of system which can apply: defined benefit earnings-related payments through the state system, mandatory private pensions, and a basic State pension with no incentives for private provision. The case of the Netherlands is also included - a system which combines a statutory scheme and a voluntary occupational system which has achieved almost 100% coverage through the use of industry-wide schemes.

Conclusion

In the current environment, many people are not making adequate supplementary pension provision. Changes may be needed to address this. The Green Paper is intended to continue the debate on the most appropriate form of any new direction on pensions and to outline various options for the most appropriate way forward. Because people are living longer, individual pensions are likely to cost more in the future. A debate is required on how such costs should be shared. In that context, we must also consider whether some form of mandatory or soft mandatory provision would be appropriate and the Green Paper outlines options in this regard (see Chapter 8).

It is clear, however, that pensions are also a form of partnership - between the State, the employer and the individual. The question arises as to whether all stakeholders are accepting appropriate responsibility and whether a new direction is required to achieve the goal of adequate replacement income in retirement. While demographic change suggests that pensions will cost more in the future, making key decisions now to ensure sustainability of our pensions system will make any transition an easier one for all. To do this, the Green Paper sets out the type of reforms that might be considered in order to improve our pensions system.

This chapter has discussed the philosophy of pension provision, particularly focusing on the need to reassess the current pensions landscape and to consider how the costs and risks associated with pension provision in the future might be shared. It is intended that the Green Paper process will examine and progress the debate on these issues.

The chapter has also outlined the direction of pensions reform in other jurisdictions, and the fact that, while facing similar challenges, responses vary widely across countries (see Appendix A). This may reflect the different social, economic and political contexts in which decisions are made, as well as the starting point from which reforms begin.

In addition, a brief overview of the objectives of the Irish pension system has set the scene for the discussion in the following chapters. These objectives need to be considered by all of the interests concerned if we are to proceed with a reform strategy that will work. Indeed, while it is possible to consider these objectives separately, the Green Paper shows the overlaps and interlinkages between the different objectives, affecting employees, employers, the self-employed and pensioners alike. The pensions issue is one which presents challenges across society as a whole. Our response to these challenges should be a shared one. The Green Paper process offers the opportunity for all stakeholders to participate in finding equitable and effective solutions.

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The Current System and its Overall Philosophy


The pensions system in Ireland comprises two main elements. The first is the State-run Social Welfare system and the second comprises voluntary supplementary pensions provided through a variety of arrangements and regulated by the State. The overall objective of our pensions system is to provide an adequate basic standard of living through direct State supports and to encourage people to make supplementary pension provision so that they may have an adequate income in retirement.

It is an objective of the Social Welfare pension system to provide income and other supports at an adequate level. Pension adequacy is also about the maintenance of a level of retirement income which is adequately related to pre-retirement income.

In common with many other countries, Ireland is experiencing demographic changes which increasingly, over time, will add considerably to the cost of pension provision. Therefore, along with the focus on adequate income in retirement, a key objective of our pension system is sustainability.

**Modernisation** of the Irish pension system is an ongoing process. In order to provide adequate pensions and to remain sustainable, a pensions system must move in tandem with changes in the labour market. This has particular implications for women.

The current pensions system can be described as a tripartite arrangement between the State, employers and individuals. Different views on the appropriate respective roles of each of these stakeholders are held within society.

In the current environment, many people are not making adequate supplementary pension provision. Changes may be needed to address this. The Green Paper is intended to continue the debate on the most appropriate form of any new direction on pensions and to outline various options for the most appropriate way forward.