SOCIAL JUSTICE IRELAND

working to build a just society

Public consultation to help inform the Pensions Commission Guidelines and information for submissions

Social Justice Ireland's submission to the Pension's Commission - 2021

Introduction

Social Justice Ireland welcomes the opportunity to make a submission to the consultation process on State Pensions into the future. This submission will seek to respond to the questions set out in the Consultation Paper and provide an alternative to the current State pension system.

We would welcome the opportunity to meet with members of the Commission to discuss these proposals, or indeed any other matters, in more detail if necessary.

1. Expectations of a State Pension

"Pensions do not exist to increase national savings or to provide jobs for actuaries, tax lawyers, accountants, fund managers and regulators. Their purpose is to allow the elderly and disabled to retire from work with dignity"

- United Nations Department of Economic and Social Affairs (2000)

Maintaining Living Standards into Retirement

In 1998 the Pensions Board's National Pensions Policy Initiative[1] set a target of ensuring that a combination of pensions from all sources (State and occupational or private pensions) were adequate to cover 50 per cent of an individual's pre-retirement income. Acknowledging that 50 per cent is an arbitrary target, however in the absence of anything more concrete, we will work on the basis that it is a sensible one.

A 2014 study by Collins and Hughes[2] found that taking the median contribution to a private pension - calculated by them to be €3,300 per annum - as an example, contributing to a pension for 40 years will provide an annual income in retirement of approximately €5,200. Combined with the prevailing State Pension, this gave a replacement rate in 2014 of 37.5 per cent for a median pension contributor. So the median contributor should be expected to achieve about 75 per cent of the target.

Research by TILDA[3] indicates that retirement income replacement rates were not associated with quality of life after retirement. Instead they found that it is actual income in retirement, rather than the proportionate change in someone's income from that received before retirement, that most affects quality of life. TILDA found that all aspects of quality of life, including control, autonomy, self-realisation and pleasure, increase consistently with household income. That's actual income, not proportions of previous income. This would suggest that policies aimed at achieving a certain rate of replacement to pre-retirement income should not be given as much priority as policies seeking to achieve a minimum income floor for retirees – something that the State Pension is best positioned to provide.

It's also worth noting that research by the ESRI[4] which points out that the relationship between the conventional earnings replacement rate and continuity in living standards is relatively weak and suggests an examination of the sensitivity of replacement rates to

[1] untitled (pensionsauthority.ie)

[2] Microsoft Word - Pension Paper revised 15022017 (socialjustice.ie)

[3] Report_IncomeAdequacy.pdf (tcd.ie)

[4] A micro-macro economic analysis of pension auto-enrolment options | ESRI

things like net income (rather than gross), differences in housing costs before and after retirement, and changes in household size and composition before and after retirement. The study also suggests looking at in-work earnings over a longer time period leading up to retirement (rather than taking final earnings as a snapshot) as a way to get a more realistic picture of the pre-retirement income situation.

With all this in mind, and given that the purpose of any country's pension system is to allow elderly people to retire from work with dignity, it would make sense that the vast majority of resources within the system be allocated to providing a flat-rate universal pension to all those over the State Retirement Age, and maintaining it at a level which allowed retirees to achieve what might be considered a socially acceptable standard of living.

It is also worth noting that the example used by Collins and Hughes reflects the situation for the median contributor. Given that less than half of private sector workers are contributing to a pension, this is a long-way from being the median citizen or even the median employee. Private pensions assist too small a proportion of the population, and the even most of those they assist end up with replacement rates that are inadequate by the standards being set. The State Pension is best positioned to provide a minimum income floor for all our elderly.

2. What is good about the current pension system?

While the state social welfare pension does a reasonable job of ameliorating poverty among Ireland's elderly, there are still many who fall between the cracks. It is women who suffer most. Fewer women than men qualify for the state pension and those who do tend to receive less. Often these are women who have spent their lives in caring roles – something government needs to value more than it does.

3. What concerns you with respect to current State Pension arrangements?

At the moment, the entire thrust of pension policy in Ireland seems to be focused on the private sector, and how expanding coverage there will reduce reliance on the state in retirement. This has involved directing very expensive tax breaks towards the very profitable private pensions industry. While in theory this makes sense, the only way this policy can save the state money is if the plan is to erode the long-term value of the state social welfare pension – something that should be strongly opposed.

Yet it is the state pension which sets the floor on which the vast majority of retirees in Ireland stand. Pension-related tax incentives cost the taxpayers billions of euros every year, but benefit only those who can already afford to save for their retirement. In fact more than 70 per cent of these tax breaks go to people in the top 20 per cent of earners.

If the purpose of a national pension system is to allow a country's elderly and disabled to retire from work without fear of poverty in retirement, it would make sense that the vast majority of resources within the system be allocated to providing a flat-rate universal pension to all those over the State Pension Age, and maintaining it at a level which allowed retirees to achieve what might be considered a socially acceptable standard of living. Instead, billions of euros are being spent on a private pension system characterised by low coverage rates and a poor record of achieving income adequacy.

One of the features of the Irish State Pension is its connectivity to the labour market. Eligibility for a pension from the State is based on one of two strands:

- Social insurance contributions (PRSI);
- Means testing.

One qualifies for a State Pension in Ireland on the basis of labour market history and payment of social insurance contributions, usually over several decades, or, based on a means test that shows that you do not have the financial means to provide for yourself in retirement.

In theory, encouraging people to save for retirement will help reduce their reliance on the State and therefore the financial burden to the exchequer of paying these pensions will be reduced. However, saving for a pension is expensive. As a rough rule of thumb, every €25 saved will buy a pension of about €1 per annum for a man aged 66 (the current State Retirement Age). And that will be a flat pension which will not increase, even though the cost of living will almost certainly increase over time.

People who can afford to save sufficient amounts of money over a long period of time to buy themselves a decent pension are almost always in the labour force for several decades, so are almost always the same people who will qualify for a full - or close to a full - State Pension (Contributory) based on their PRSI history. They will also have received thousands of euros – indeed more likely tens of thousands of euros – in tax relief over many years.

This is allegedly with a view to saving the State money when they reach retirement. But the fact that they may have saved a medium-to-large pension pot and so can afford a decent annuity will not reduce the cost to the State. On the contrary, these same people will now likely qualify for a full State Pension as well.

Yes, the individuals involved will be reasonably well off, and certainly much better off in their retirement than had they not saved: they will have their State Pension (Contributory) – currently a little less than €13,000 per annum – and whatever money they are receiving from their private pension which was semi-funded by other taxpayers through the generous system of tax relief currently being implemented.

By definition, those who receive a means-tested payment have not qualified for the State Pension (Contributory) due to insufficient PRSI payments, nor have they the necessary financial means to achieve a decent standard of living in retirement. Given that they have insufficient PRSI contributions, it's safe to assume that their connectivity to the labour market over the preceding decades has not been particularly strong. They were therefore, for the most part, not in a position to avail of the tax-based incentives to contribute to private pensions as they had little or no income for the majority of that period.

What we do know about the distribution of private pension savings and the associated reliefs is this: more than 70 per cent of the relief granted to private pension contributions accrues to the top 20 per cent of earners.

It seems highly likely that, given that the opportunity cost for someone in the top income quintile to leave the workplace for a significant period of time is quite high, the majority of such recipients will qualify for a State Pension in retirement as well, with reasonably complete PRSI histories.

It is time to face facts and identify pension-related tax reliefs what they are: an expensive means of subsidising retirement savings for the better off in society, with little or no financial benefit to the State.

It should be acknowledged that, given that pensions are taxed in retirement, the exchequer will receive money back at some point. However, a significant proportion of those who receive relief at the higher marginal rate (currently 40 per cent) will pay tax in retirement at the lower standard rate (currently only 20 per cent), while many – regardless of which rate they received the relief – will have retirement incomes so low they will pay no tax at all.

The current incentive system for private pensions has a very high fiscal cost, yet is currently failing to meet its targets in relation to coverage and income adequacy in retirement. The arguments in favour of continuing this perverse incentive system do not stack up. There is little to no fiscal benefit to the exchequer in either the short or the long term, unless the eventual aim is to slowly erode the value of the State Pension over time and force people to rely on their private pension savings - something that should be strongly opposed.

4. How best to accommodate those who provided long-term care for most of their working lives?

One of the ways in which a lack of fairness has long permeated the Irish pension system is manner in which entitlement to a pension from the State has been based on social insurance contributions. This ties pension entitlements to an individual's labour market participation history and has historically resulted in lower pensions (and sometimes no pensions at all) for people (mainly women) who have spent long periods away from the labour force raising families or caring for elderly family members.

In our proposal for a Universal State Social Welfare Pension, set out in greater detail in response to questions 5 and 6 below, we provided an analysis of Ireland's pension system and a fully costed proposal for the introduction of a Universal Pension in Ireland based on residency, not on social insurance contributions.

The argument is often made that Ireland's State Pension has all angles covered: individuals qualify for a payment through (a) their social insurance contributions, or (b) through a means test: "Either you get your pension as a result of having been employed all your life, or as result of having insufficient income to live on in old age". The implication is that those who do not qualify for a State Pension payment do not need one and do not deserve one. However there are thousands of individuals who fall between cracks. In 2019, we worked with Family Carers Ireland to produce two case studies[5] which exemplify this, reproduced here for illustration:

Case Study 1: Joan

Joan* is 69 years old. She entered employment at the age of 16 in 1965. In 1974 her first child Mark* was born with a disability. Joan was unable to return to work and devoted her life to caring for Mark who required fulltime care. Joan reached age 66 in 2015 and was advised by the Department of Social Protection that as she had only 460 paid contributions and 62 reckonable contributions she would not qualify for the State Pension (Contributory).

Because Joan's husband was employed as a civil servant and paid a Class B stamp (pre-1995), his civil service pension was fully assessable in the means test of the State Pension (Non-Contributory) and so Joan didn't qualify for either the State Pension (Non-Contributory) or an increase for a Qualified Adult (IQA), nor could she make voluntary contributions. Therefore, despite caring fulltime for Mark for 43 years, Joan has no entitlement to Carers Allowance or any State Pension and so relies entirely on her husband for financial support.

Case Study 2: Brid

Brid has cared for her daughter Ann since she was born with Down Syndrome in 1980. She does not qualify for the State Pension (Contributory) as she has only 434 paid contributions. Brid's husband is a retired farmer with 60 acres of land. The land is not leased or used productively and is valued at €250,000. Because the value of the land exceeds the current statutory limit (€257.50) Brid does not qualify for a Non-Contributory pension.

Few people would consider Joan or Brid to be undeserving of a State Pension payment, but situations like these are what the current system has created.

With an ageing population and the number of people in defined benefit schemes falling, it is clear that the shortcomings in Ireland's pension system need to be addressed urgently.

5. What specific policy, provision or other changes are needed to make State Pension arrangements sustainable into the future?

The best use of the resources already available to the Irish pension system would be to direct them towards funding a flat-rate universal pension payment from the State that would ensure that older people can retire with sufficient income to live life with dignity and without the prospect of exposure to poverty in their retirement.

[5] Names have been changed to protect identities.

A Universal State Social Welfare Pension[6] is an analysis of Ireland's pension system and a fully costed proposal for the introduction of a Universal Pension in Ireland based on residency, not social insurance contributions.

Social Justice Ireland proposes three key adjustments to the present system:

On equity: ensure every older person who has been resident in Ireland will receive a full pension payment.

On sustainability: make the system more sustainable by standard rating employee contributions to private pensions (unlike the current system which gives tax relief at the marginal rate which results in the major benefits going to the higher paid).

On bureaucracy: dramatically reduce the bureaucracy by having only one test for accessing the payment and eliminating the myriad of conditions that are part of the current or the Government's proposed systems.

With an ageing population and the number of people in defined benefit schemes falling, it is clear that the shortcomings in Ireland's pension system need to be addressed urgently.

5. Sustainable Reform Proposals

Social Justice Ireland's proposal shows how to fund a Universal Pension System based on residency. This would replace all other social welfare pension payments and would be funded by a restructuring of the tax relief system on private pensions and a modest increase in Employer PRSI. This is the best way to achieve a fairer and more equal Ireland. It is proposed that the Universal Pension would start at €243.30 a week, the same as the current State Pension (contributory). It would be residency based, meaning that the more working-age years a person is resident in Ireland, the higher the percentage of the full pension they receive. 40 years of residency between the age of 16 and the State Pension Age would entitle a person to the full amount.

Introducing this system would have cost the State approximately €727m in 2019. There would be two primary mechanisms to fund this. First, reducing the rate of tax relief on private pensions from 40% to 20% and second increasing employers PRSI by 0.5%. These, along with some other smaller measures, would raise in the region of €949m, which is €200m+ more than the additional cost of the Universal Pension in 2019. The study goes on to argue that the social welfare pension should rise to 35% of average earnings and be maintained at that level in the decades ahead. The study projects the numbers forward to 2046.

A full copy of our proposal is available to download from our website at universalstatesocialwelfarepension.pdf (socialjustice.ie)

[6] universalstatesocialwelfarepension.pdf (socialjustice.ie)

Social Justice Ireland is an independent think-tank and justice advocacy organisation of individuals and groups throughout Ireland who are committed to working to build a just society where human rights are respected, human dignity is protected, human development is facilitated and the environment is respected and protected.

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