

# Policy Submission

**Submission to the Pensions Board  
on the Pensions Review**

**September 2005**



**SUBMISSION TO THE NATIONAL PENSIONS  
BOARD**

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## 1. Introduction

- 1.1. The Combat Poverty Agency is a state advisory agency working for a poverty-free Ireland by striving for change which will promote a fairer and more just, equitable and inclusive society. In particular, the Agency works towards a reduction in existing poverty levels by promoting the re-distribution of income and resources in favour of those living in poverty through reform of the taxation and social-welfare systems, and by working to ensure that everyone has at least a minimally adequate income. It is a centre of expertise on poverty issues, policies and practices. A key element of its work is advising government on all aspects of economic and social planning in relation to poverty.
- 1.2. The Submission is structured as follows. The next Section outlines some contextual information on pensioners and poverty. The main issues with regard to pensions from a poverty perspective are briefly outlined in Section 3, while some policy recommendations are delineated in Section 4.

## 2. Pensioner Poverty

- 2.1. According to the latest (2003) data from the Central Statistics Office<sup>1</sup>, some 36.4% of those aged over 65 years of age live in income poverty, i.e. household income less than 60% of the median; this means that 161,000 people over-65 are income-poor. Such an incidence is far higher than the incidence reported for the population as a whole (22.7%).
- 2.2. In addition, 7% of those over 65 years live in consistent poverty, i.e. below 60% median income and enduring enforced deprivation; this amounts to 32,000 older people.
- 2.3. Older women are exposed to an elevated risk of income poverty, with 40.7% below the 60% income threshold, compared with 30.6% of men aged over 65<sup>2</sup>.
- 2.4. There has been a significant deterioration in recent years as regards the risk of poverty for older people. Statistics from Whelan *et al.* (2003)<sup>3</sup> indicate that income poverty (measured at the 60% income threshold) has increased from 5.3% in 1994 to over 49% in 2001 for pensioners. This is the largest proportionate increase in income poverty among all welfare-dependent households and is owing to the fact that, despite nominal increases, pensions have not kept in line with average wage growth in Ireland over the past decade.
- 2.5. The *National Anti-Poverty Strategy* (NAPS)<sup>4</sup> and *National Action Plan against Poverty and Social Exclusion* (NAP/incl)<sup>5</sup> identify older people as a particularly vulnerable group to poverty, and both documents contain a number of targets in relation to income support and service provision for the elderly.
- 2.6. In the absence of targeted intervention, poverty risks are unlikely to decrease for pensioners owing to the very challenging demographic pressures lying ahead which will see Ireland's over-65 population accounting for one-fifth of the population by 2036; this compares with 11% in 2001. The projections show more than 1.1 million people aged over 65 in 2036 compared with 430,000 in 2001. The number of "oldest old" persons (those aged 80 years and over) is projected to more than treble from a 2001 level of 98,000 to about 320,000 in 2036<sup>6</sup>. These

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<sup>1</sup> CSO (2005). *EU Survey on Income and Living Conditions: 1<sup>st</sup> Results*, January 2005: CSO: Dublin.

<sup>2</sup> *Ob cit.*

<sup>3</sup> Whelan, C.T., Layte, R., Maitre, B., Gannon, B., Nolan, B., Watson, D., and Williams, J. (2003). *Monitoring Poverty Trends in Ireland: Results from the 2001 Living in Ireland Survey*, ESRI: Dublin.

<sup>4</sup> Department of Social and Family Affairs (1997). *The National Anti-Poverty Strategy*, Department of Social and Family Affairs: Dublin.

<sup>5</sup> Office for Social Inclusion (2002). *National Action Plan against Poverty and Social Exclusion 2003-2005*, Office for Social Inclusion: Dublin.

<sup>6</sup> <http://www.cso.ie/census/documents/PressReleasePopandLabourWebVersion.pdf>

demographics paint a challenging picture ahead for both pensioners and for the Government in terms of meeting future pension bills. A national pensions' strategy needs to put in place policies that will ensure that the incidence of pensioner poverty does not rise further because of these forecasted demographic pressures.

### 3. Issues for Consideration

#### 3.1. *Pre-Retirement*

Households living in poverty before entering retirement are very unlikely to rise out of poverty once in retirement. Chronic poverty over time is likely to result in enforced deprivation, and some 7% of households aged over 65 years are in consistent poverty with incomes below 60% of the median and deprived of one or more basic deprivation indicators. This entails that poorer households will find it particularly difficult to save money for their retirement or invest in private pensions.

#### 3.2. *The adequacy of the state pension*

Updating an original time-series data from Vaughan (1997)<sup>7</sup> reveals that, as a percentage of gross average industrial earnings, the Old-Age Contributory Pension has fallen from 38.2% of GAIE in 1987 to approximately 31% of GAIE in 2005.

There have been many statements made over the past years about linking pensions to average earnings, or what is often referred to as 'adequacy standards' for pensions. The *National Pensions Policy Initiative Report* recommended that social welfare pensions be linked to gross average industrial earnings (GAIE) and to increase pensions over a five- to ten-year period to 34% of GAIE; this recommendation was made in May 1998.

This is a sensible and practical recommendation which should be taken on board. Setting a target related to actual living standards rather than arbitrary monetary targets, is far more progressive and takes into account rising living standards over time and the need for pensions to be linked to wage growth to ensure that pensioners do not face higher poverty risks. The State pension has been falling as a proportion of GAIE for the past two decades<sup>8</sup>.

The *Programme for Government* stated that the social welfare pension would rise to €200 per week by the year 2007. Any Pensions' Strategy needs to take cognisance of the need for pension adequacy.

#### 3.3. *Contributory Coverage*

Increased coverage of the contributory old-age pension should be pursued as a policy goal, as this reduces both the individual pensioner's risk of poverty in retirement (owing to the increased contributory pension rate), and also the burden on the State as regards pension contributions. This policy could be achieved without the need for means-testing of other (non-pension) income. Regulatory or incentivisation instruments could be considered.

#### 3.4. *Retirement Pension*

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<sup>7</sup> Vaughan, A. (1997). 'Identifying Directions in Social Welfare Pensions: Policy Development and Future Issues', Presentation to the Irish Centre for Commercial Law Studies, UCD, Seminar on *Securing a Firm Foundation for Irish Pensions*.

<sup>8</sup> [www.esri.ie](http://www.esri.ie)

The current retirement pension, payable at age 65, which prohibits those drawing down this pension from paid employment, should be abolished. Combat Poverty argues there is no reasonable rationale to the prohibition of paid employment at age 65 for those who wish to do so. This would mean bringing forward the commencement of the old age pension to 65 years.

### 3.5 *Second tier pensions*

Pensions should not alone ensure people avoid poverty, they also compensate for loss of earned income upon retirement. This is mainly achieved through occupational or second tier pensions. Over half the population currently do not have a second tier pension. Furthermore, Hughes (2005) demonstrates that pension entitlements are highly related to occupation, with some 86% of those in public administration and 71% of professionals covered by pensions, compared to about 12% of those in agriculture. Similarly low levels of pension entitlements are found among those in personal services, retail, building and producers/wholesaling. A mixed picture is found when statistics are examined on employees versus the self-employed and pension provision. Of those in the very highest income decile, 82% of employees are covered by pensions, compared to 60% of the self-employed.

### 3.6 PRSAs

To address this shortfall in occupational pension coverage, the government introduced the Personal Retirement Savings Account (PRSA) to provide a low-cost and accessible form of second tier coverage. PRSA is a voluntary option, and the take-up has been low to-date. Combat Poverty believes that PRSAs should be made compulsory for all those in employment and paid for through the PRSI system including both an employee and employers contribution to the fund. This fund would be separate from the social insurance fund and would be provided on a defined contribution basis, ie the contributor gets exactly the benefit of their own contribution.

### 3.5 *Cost of pensions*

Total pensions' expenditure has fallen from 4% of national income in 1980 to 2.2% in 2004<sup>9</sup>. Despite this, the number of pensioners as a percentage of the population has increased from 59% in 1994 to 67% in 2004. There are three components to this expenditure: the state pension, public sector pensions and tax relief on pensions. According to data from the Department of Finance, the cost of tax reliefs on private pensions amounts to approximately €1.5 billion<sup>10</sup>. This is in excess of the total cost of the State non-contributory pension, which amounted to €565m in 2003<sup>11</sup>, and both the contributory old-age pension and the retirement pension combined (€1.2 billion)<sup>12</sup>. Public sector pensions are fully funded out of the public finances and dwarf welfare pensions in terms of cost.

### 3.6 *Tax relief on pensions*

Tax reliefs on pensions have a strong inequity effect, as they benefit primarily those in the top income quintile. Using 2000 data, Hughes (2005) reports that, while 65% of employees and 78% of those self-employed in the top income quintile claim tax relief on private pensions, less than 3% of employees and

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<sup>9</sup> See: Timonen, V. (2005). *Irish Social Expenditure in a Comparative International Context: Epilogue*, Combat Poverty Agency: Dublin; and McCashin, A. (2005). 'The State Pension – Towards a Basic Income for the Elderly' in Stewart, J. *For Richer, For Poorer: An Investigation of the Irish Pension System*, TASC: Dublin.

<sup>10</sup> Tax Strategy Group (2004). *Tax Incentives/Expenditures and Broadening the Tax Base*, TSG 04/22: Department of Finance: Dublin.

<sup>11</sup> Department of Social and Family Affairs (2003). *Statistical Information on Social Welfare Services*, Department of Social and Family Affairs: Dublin.

<sup>12</sup> Hughes, G. (2005). 'Pension Tax Reliefs and Equity', in Stewart, J. *For Richer, For Poorer: An Investigation of the Irish Pension System*, TASC: Dublin.

virtually no self-employed individuals in the bottom income quintile avail of such reliefs. A positive, linear distributional relationship is illustrated by Hughes with regard to household income and pension tax reliefs. In addition, there is some evidence that pension tax relief is being used to leverage property investments, which was not its original intention.

### 3.7 *Retirement Age*

Combat Poverty believes that individuals should not be forced to retire at age 65, but should, instead, be allowed to continue to participate – voluntarily – in the labour force for as long as they are fit and able to undertake their post. An incentive to defer pensions could be considered. Such a policy shift would have benefits to the State finances in terms of forgone pension expenditures (on the costs' side) and taxes gained (on the revenue side).

### 3.8 *Conclusion*

The increasing risk of income poverty for pensioners is related to the structure of pension provision. Policy must prioritise this issue, however this will not be particularly easy in light of the aforementioned demographic challenges lying ahead. A combination of policies aimed at: (a) increasing the flexibility of the retirement age, (b) a mandatory basis to PRSAs, and (c) curtailing excessive tax relief on pensions should improve the effectiveness, efficiency and sustainability of pension policy.

## 4 **Recommendations**

- 4.1. The basic state pension should be adequate to provide sufficient income for pensioners to live in a manner compatible with human dignity and avoid poverty. In order to ensure the pensions do not fall significantly behind living standards, Combat Poverty argues that an adequacy target for pensions that is linked to average wages needs to be set and written into Government policy.
- 4.2. The Retirement Pension at age 65 should be abolished so that older people can continue to contribute to the economy if they wish to do so.
- 4.3. Combat Poverty believes that PRSAs should be made compulsory for all those in employment and paid for using a PRSI contribution together with a mandatory employers' contribution to the fund.
- 4.4. Tax relief on private pensions should be reviewed, in regard to the inappropriate use of pension relief. This issue should be considered in the context of the general review of tax reliefs announced by the Government in the 2004 Budget.<sup>13</sup>
- 4.5. The mandatory retirement age of 65 should be abolished in an effort to allow those who wish to remain actively involved in the labour force to do so.
- 4.6. Consideration should be given to the sustainability of welfare pensions over the longer term. The opportunity exists in Ireland to do this more so than in many other EU countries, thanks to relatively benign dependency ratios. Various options such as re-deployment of alternative state resources and redistributive mechanisms should be considered in preference to limiting contributory pensions or detaching increases in pensions from prevailing living standards.
- 4.7. National Pensions Policy should ensure that all citizens who reach retirement age who are long-term incapacitated, or in the case of dependants on the death of the

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<sup>13</sup> Combat Poverty Agency (2005), *Review of Tax Reliefs and Exemptions for High Earners*, Submission to the Department of Finance.

income provider and who have no other income, should receive a state pension which is adequate to maintain a standard of living compatible with prevailing living conditions<sup>14</sup>.

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<sup>14</sup> See: Combat Poverty Agency (1997). *Progressing Pensions against Poverty: a Response to the National Pensions Policy Initiative*, Combat Poverty Agency: Dublin.