Combat Poverty Agency
working for a poverty-free Ireland

Policy Submission

Submission on the Green Paper on Pensions

June 2008

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1. Introduction

Combat Poverty is a State advisory agency that develops and promotes evidence-based proposals and measures on all aspects of social and economic planning in relation to poverty in Ireland

The Government published the Green Paper on Pensions to stimulate debate on the challenges and options for the development of pensions.

In preparation for its submission, Combat Poverty hosted a roundtable discussion on pensions and poverty, which was attended by a range of stakeholders, including board members, staff, researchers, government officials and social partners.

Further information on the submission is available from Jim Walsh, Policy and Research Analyst, at jim.walsh@combatpoverty.ie or 01-6026613.

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2. Summary

The key policy issue in regard to pensions is to reduce the rate of 'pensioner poverty'. Income poverty affects 13.6 per cent of older people, the equivalent of 63,000 persons.[1] In recent years, the income poverty rate among older people has fallen significantly and is now below that of the total population. Compared to other European countries, however, the Irish income poverty rate for older people is still above the EU norm (one and a half times the average) and is up to three times the rate in the best performing European countries.

Pensioner poverty is heavily influenced by the level of the state pension as this is the primary income source for older people. Thus, recent falls in poverty among older people is directly attributable to significant increases in the state pension. There is evidence, however, that the Irish state pension is still less effective than that of other countries in reducing the rate of poverty among older people.

The main policy priority in this submission is therefore to ensure the state pension provides a minimum adequate income for all recipients. An adequate figure should be based on a percentage of average earnings, so as to reflect prevailing living standards.

The state pension should continue to be based on Pay Related Social Insurance (PRSI), supported by a non-contributory means-tested pension. There are three challenges here: first, to broaden the eligibility conditions so that more people get the contributory pension; second, to generate sufficient resources to meet future pension costs and third, to encourage and facilitate older people to remain in employment after official retirement age.

A second policy issue is how to improve the coverage of supplementary pensions. The preferred Combat Poverty option is to use the existing PRSI system to introduce a pay-related pension provision. This would be mandatory

[1] Two per cent of older people (10,000 persons) are in consistent poverty (that is, are both income poor and deprived of basic necessities).

for all employees and would include both an employee and an employer contribution.

Finally, policy should review the state funding and support of occupational, public sector and private pensions. Combat Poverty believes that both tax reliefs and public sector pensions should be restructured to ensure greater equity and to control cost.

Main proposals

- The State pension should provide a minimum adequate income for pensioners to live on and which prevents poverty. The preferred way to ensure adequacy is to link the state pension to average earnings, with a proposed target of 50 per cent of average earnings.

- Eligibility conditions for the State pension should be simplified to include people with a limited employment history due to caring responsibilities or disability.

- A supplementary earning-related pension scheme should be introduced through the PRSI system. There would be an opt-out mechanism where an employee already has a private or occupational pension. Both employers and employees would contribute to the pension fund.

- Tax relief for voluntary private and occupational pensions should be provided as a pension credit, similar to mortgage interest relief. It would be tapered to give equal support to low and middle income groups and younger people. There would also be a cap on the maximum level of pension credit.

- The structure of public service pensions should be reformed to ensure a greater focus on lower-paid employees.

- The transition pension, which requires people to cease work at the age of 65, should be abolished and replaced with a mechanism that facilitates continuation of work post-retirement age.

- Disregards for savings and earnings should be increased for pensioners on means-tested payments.

3. Key challenges: pensioner poverty and population ageing

3.1 Pensioner poverty

A core objective of the pensions system is to ensure that older people have a minimum adequate income in retirement. One measure of adequacy is the extent to which pensions prevent older people from falling into poverty. Poverty is measured in two ways

- The EU measure of 'at-risk-of-poverty' (low income)
- The Irish Government measure of 'consistent poverty' (low income and deprivation of necessities)

The latest figures on pensioner poverty are for 2006 (table 1). The 'at-risk-of-poverty' rate among older people is 13.6 per cent. This is less than the rate for the total population of 17 per cent. In numerical terms, there are an estimated 63,600 older people with weekly incomes of less than €202.50 per week for an individual or €336.15 per week for a couple. Older people represent 9 per cent of all people 'at-risk-of-poverty'.

Table 1: Poverty among older people, 2006[2]

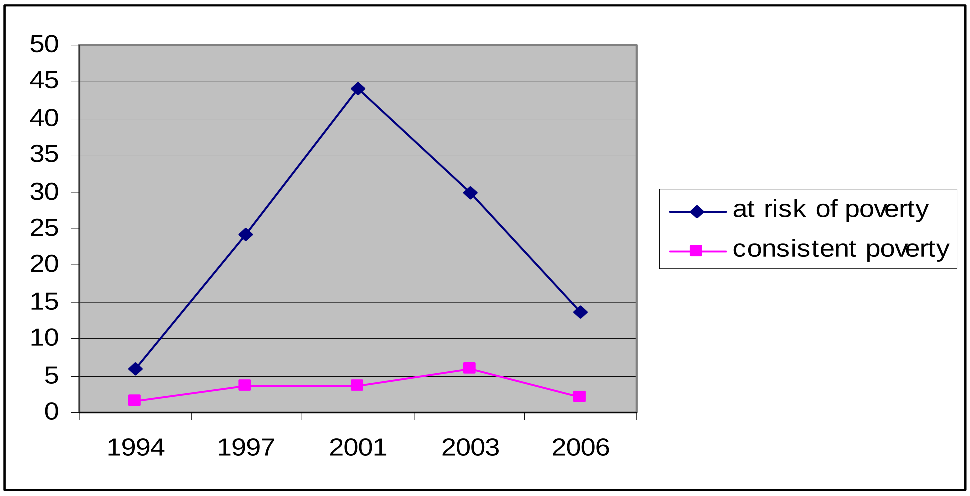
at risk of poverty				consistent poverty			
older people	total population	number of older people	share of total	older people	total population	number of older people	share of total
13.6%	17%	63,600	8.9%	2.1%	6.9%	9,800	3.4%

The rate of consistent poverty among older people is 2.1 per cent, or one-sixth the rate of income poverty. This compares with a rate for the total population of 6.9 per cent. In numerical terms, there are an estimated 9,800 older people in consistent poverty. This is the equivalent of 3.4 per cent of all people in consistent poverty. There are no significant gender differences in the level of pensioner poverty.

[2] Central Statistics Office (2007), *EU Survey on Income and Living Conditions (EU SILC) 2006,* Dublin: Stationery Office

Diagram 1 presents trends in poverty among older people over time. Between 1994 and 2006, income poverty among older people more than doubled, from 5.9 per cent to 13.6 per cent. However, this cumulative change only tells part of the story. The rate of pensioner income poverty grew dramatically in the late 1990s to 25 per cent in 1997 and 45 per cent in 2001. Thereafter, it decreased, again quite dramatically to 30 per cent in 2003 before arriving at the current rate of 13.5 per cent in 2006. By contrast, the trend in consistent poverty among older people is quite stable. Between 1994 and 2006, the rate of consistent poverty grew from 1.5 per cent to 2.1 per cent. There is some variation within this period, with a gradual increase in the level of consistent poverty to a peak of 5.8 per cent in 2003, before falling back again to the current level of 2.1 per cent.

Diagram 1: Trends in pensioner poverty 1994-2006[3]

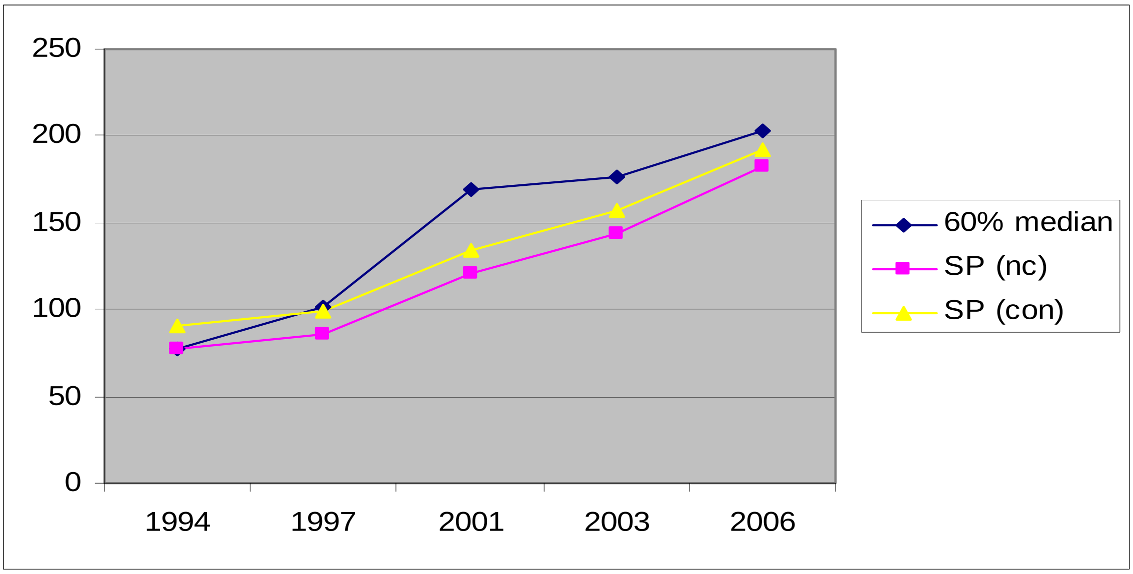


What is the explanation for this volatile pattern of pensioner income poverty? Diagram 2 sheds some light on these questions by tracing the evolution of the income poverty threshold and the state pension since 1994.[4] Focusing on the state pension is important because over half of pension income comes from welfare transfers. The diagram shows that the state pension (both contributory and non-contributory) was slightly ahead of the poverty threshold in 1994. Since then, the state pension has not kept pace with the poverty threshold, as

[3] Data drawn from Living in Ireland Survey and EU SILC (various ESRI and CSO publications)
[4] Data drawn from the Department of Social and Family Affairs, the Living in Ireland Survey and EU SILC (various ESRI and CSO publications).

household incomes rose dramatically due to increased employment and higher earnings. The gap was widest at the start of the 2000s, with a differential of between €35 and €50 per week between the state pension and the poverty threshold (a shortfall of between 20 to 30 per cent). The gap narrowed in the first half of the 2000s, and by 2006 stood at €10 to €20 per week (5-10 per cent).

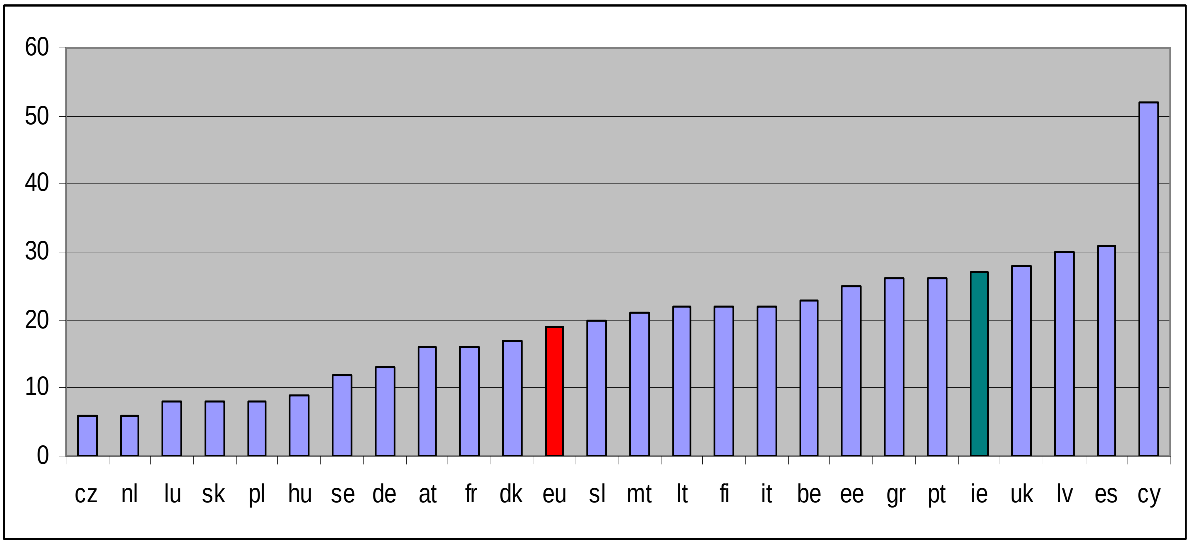
Diagram 2: The evolution of the poverty threshold and the state pension, 1994-2006



We now look at the Irish rate of pensioner poverty in an EU context using the 'at-risk-of-poverty' indicator (diagram 3).[5] First we note some differences in the way that income poverty is calculated at the EU level, including the definition of income and the choice of equivalence scales.[6] Under this methodology, Ireland's pensioner poverty rate is recorded as 27 per cent (twice the rate using the national measure). What we focus on here, however, is the ranking of Ireland compared with other EU member states. We emphasise two points: first, Ireland has the fifth highest rate of income poverty among older people in the EU, which is 50 per cent higher that the EU norm; second, the rate of pensioner poverty in the best performing countries is less than 10 percent, which is a third of the Irish rate.

[5] Data sourced from Eurostat at www.eurostat.eu
[6] See Central Statistics Office (2007), *op cit*, for details.

Diagram 3: EU poverty rate for older people, 2006
(at-risk-of-poverty measure; 60% of median)



Finally, there is some evidence that the Irish pension transfers are less efficient than in other EU countries in reducing pensioner poverty and also that Ireland relies more heavily on means-tested social transfers to reduce poverty. Thus, pensions reduce income poverty from 86 per cent to 40 per cent in Ireland compared to an average reduction from 90 per cent to 23 per cent in the EU. Means-tested transfers reduce poverty in Ireland by a further 13 per cent to 27 per cent, while the EU norm is a reduction of 4 per cent to 19 per cent.[7]

[7] Data sourced from Eurostat at www.eurostat.eu .

3.2 Population ageing

Another challenge for pensions' policy is the demographic pressures arising from an ageing population. It is forecast that the share of the population over 65 years will rise to almost one-fifth by 2036 (the equivalent of 1.24 million); this compares with 11 per cent in 2006 (462,000).[8] Thus, we will have substantially more older people in receipt of pensions and other social provision. In addition, funding this support will be levied on a smaller productive category of the population. The number of "oldest old" persons (those aged 80 years and over) is projected to more than treble from a 2006 level of 112,200 to about 386,800 in 2036.[9] These demographics paint a challenging picture ahead in terms of meeting future pension bills. They also highlight the danger of increased numbers in pensioner poverty.

4. Issues for Consideration

4.1 The adequacy of the state pension

The state pension has fallen as a proportion of gross average industrial earnings (GAIE) over the past two decades.[10] Updating an original time-series data from Vaughan[11] reveals that the state pension had fallen from 38.2 per cent of GAIE in 1987 to approximately 31 per cent in 2005. There have been policy statements in past years about linking pensions to average earnings, what is often referred to as 'adequacy standards' for pensions. The *National Pensions Policy Initiative Report* recommended that social welfare pensions be linked to GAIE and to increase pensions over a five- to ten-year period to 34 per cent of GAIE; this recommendation was made in May 1998. The *Programme for Government 2007-2012* sets €300 as the policy target for the state pension, to be achieved by 2012.

Setting a target related to actual living standards - rather than monetary targets – is preferable as it takes into account rising living standards. It is also

[8] Central Statistics Office (2008), *Population and Labour Force Projections 2011*-2041, Dublin: Stationery Office

[9] Ibid

[10] www.esri.ie

[11] Vaughan, Ann (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*.

important that pensioners' income should be linked to wage growth to ensure that pensioners do not face higher poverty risks. A state pension target of 40 per cent, rising to 50 per cent of GAIE in the long-term, is proposed.

4.2 Contributory Coverage

Increased coverage of the contributory state 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 pension rate), and also the burden on the State as regards pension contributions.

4.3 Pensions and employment

The current retirement pension, payable at age 65, which prohibits those drawing down this pension from paid employment, should be reformed. More generally, people in receipt of the state pension should be encouraged to continue in the labour force for as long as they are fit and able to undertake their post.

4.4 Second tier pensions

As well as ensuring people avoid poverty, pensions' policy also seeks to ensure that older people maintain a standard of living relative to their pre-retirement situation. This is mainly achieved through supplementary pensions. Just over half of the population have a supplementary, despite the expenditure of considerable public resources to support private pensions. Hughes demonstrates that pension entitlements are highly related to occupation, with some 86 per cent of those in public administration and 71 per cent of professionals covered by pensions, compared to about 12 per cent of those in agriculture.[12] 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 per cent of employees (public and private) are covered by pensions compared to 60 per cent of the self-employed.

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

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. A number of commentators, including the Pension's Board, have examined how a compulsory scheme could be implemented to increase take-up. The preferred solution to low coverage is to introduce a mandatory supplementary pension through the PRSI system.

4.5 Cost of pensions

Total pensions' expenditure fell from 4 per cent of national income in 1980 to 2.2 per cent in 2004.[13] Despite this, the number of pensioners as a percentage of the population has increased from 59 per cent in 1994 to 67 per cent in 2004. There are three components to this expenditure: the state pension, public sector pensions and tax relief on pensions. The cost of the State pension amounted to €1.75 billion in 2003[14] and the cost of tax reliefs on private pensions was approximately €1.5 billion.[15] Public sector pensions are fully funded out of the public finances and dwarf welfare pensions in terms of cost.

4.6 Tax relief on pensions

Tax reliefs on pensions have a strong inequity effect, as they benefit primarily those in the top income quintile. Hughes reports that 65 per cent of employees and 78 per cent of those self-employed in the top income quintile claim tax relief on private pensions, less than 3 per cent of employees and virtually no self-employed individuals in the bottom income quintile avail of such reliefs.[16] There is a positive, linear distributional relationship with regard to household

[13] 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.

[14] Department of Social and Family Affairs (2003). Statistical Information on Social Welfare Services, Department of Social and Family Affairs: Dublin.

[15] Tax Strategy Group (2004). *Tax Incentives/Expenditures and Broadening the Tax Base,* TSG 04/22: Department of Finance: Dublin.

[16] Ibid

income and pension tax reliefs. In addition, there is evidence that pension tax relief is being used to create personal wealth, which is not its original intention. Callan et al estimate that over 75 per cent of tax reliefs goes to the richest quintile of family units.[17] As a result, the greatest beneficiaries of tax relief are those who have the least needs. These findings raise two questions:

- whether the public resources provided for tax relief on private pensions could be re-distributed to improve pensions for low-income groups, by funding an increased state pension (as suggested by Callan et al, 2008)

- whether the existing resources could be re-allocated within the tax system to support private pensions in a progressive manner, by capping the maximum amount of relief or by limiting relief to the standard rate of tax.

4.7 Retirement Age

The official retirement age is 65. This has remained unchanged while life expectancy rates have increased by half over the last 30 years and are predicted to continue to improve. Keeping the retirement age at 65 years has an economic cost in terms of the cost of pensions and the loss of potential employees. It also has a personal cost in that people may experience a significant drop in income post-retirement. It seems logical that the retirement age is gradually increased over time. A voluntary incentive to defer pensions could also be considered. Deferring retirement age would have a double benefit for the public finances in terms of forgone pension expenditures (on the cost side) and taxes gained (on the revenue side).

[17] Callan, T, Nolan, B and Walsh, J.R (2007), 'Pension priorities: getting the balance rights?', in Callan, T (ed), *Budget Perspectives 2008*