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Pension policy in Ireland: An Evaluation – How we might better achieve its stated aims

Eamon Murphy

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Nevin Economic Research Institute (NERI)

31/32 Parnell Square
Dublin 1
Phone + 353 1 8897722

Carlin House
4-6 Donegall Street Place
Belfast
BT1 2FN,
Northern Ireland
Phone +44 28 902 46214

Email: info@NERInstitute.net
Web: www.NERInstitute.net

PENSION POLICY IN IRELAND: AN EVALUATION – HOW WE MIGHT BETTER ACHIEVE ITS STATED AIMS

Eamon Murphy*

Keywords: Ireland, Pensions Policy, Tax Expenditures, Income

ABSTRACT

This paper sets out to evaluate pension policy in Ireland. By ascertaining the system's stated aims, it then appraises its performance in achieving them. The main purpose of the paper is to suggest a change to the system that would better achieve these aims.

This Study is driven by economic, moral and social imperatives. It advances the argument for the social responsibility of a society to provide for its most vulnerable, and to do so in a way that is equitable, affordable and sustainable.

Using population projections devised by the Central Statistics Office and incorporating numerous economic and fiscal assumptions, the research shows that it is possible to achieve each objective of the system as set out by the Irish government in the Green Paper on Pensions, as well as a number of additional and complementary objectives suggested by this Study.

The key findings are that the system can be made more financially equitable and less discriminatory, while bringing universal pension coverage to the country and thusly eliminating poverty among the elderly. More importantly, this can be done at no immediate additional cost to the Exchequer and at an affordable and sustainable cost in the long-term.

This paper recommends a reduction in the extent to which the Exchequer supports private pension arrangements via the tax regime, and suggests using money saved to implement part, or all, of the proposal made in this Study.

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* The author acknowledges the assistance and advice of Dr Micheál Collins, NERI, whose comments and suggestions on earlier versions of this paper greatly assisted in its emergence. The usual disclaimer applies. All correspondents to eamonmurphy83@hotmail.com

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"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)

1. Introduction

Pensions and their Objectives

Pensions as a public policy issue have evolved beyond recognition from when Otto von Bismarck instituted the first State pension in Prussia in 1889 (Holborn, 1969, pp. 291-293). The epigraph from the United Nations Department of Economic and Social Affairs – see preceding page – serves to highlight how far developed as a policy and regulatory concern pensions have become, as well as the number of interested parties involved. Yet this statement also serves to show that there remains still today an element of Bismarck's original intention – and this is not to refer to his desire to undercut the appeal of Socialism[1] at the time!

Pensions were instituted to allow the aged to retire from the workforce without the prospect of a life of poverty, and the states which followed the German example generally had the same high aim in mind.

Ireland – or the United Kingdom, which was the prevailing power at the time of the island's first old-age pension – was no different. 'In 1908, after a long campaign by those determined to do something for the biggest group of paupers in British society, the aged poor, the then Liberal government piloted the eight page *Old Age Pensions Act* through Parliament' (Salter, Bryans, Redman & Hewitt, 2009). That same aim of poverty prevention was referred to repeatedly in the Irish Government's *Green Paper on Pensions* (Department of Social and Family Affairs, 2007), a document that illustrates clearly that though the pension's original intention may have changed little, the manner in which the system works today bears no resemblance to its beginnings.

While the economic climate in which the Green Paper was published has changed almost beyond recognition, demographic projections and the core aim of adequate retirement provision for the country's elderly still hold. For this reason, the Green Paper will provide an important reference point for this Study.

The *Green Paper on Pensions* (Department of Social and Family Affairs, 2007, p.12; p.24; p.4) states that the objectives of the Irish pension system are;

1. To provide an adequate basic standard of living through direct State supports
2. To encourage people to make supplementary pension provision so that they may have an adequate income in retirement
3. Sustainability
4. Modernisation

[1] Bismarck 'perceived an opportunity to tie the new industrial working class into the support of the State as the collector of contributions and the guarantor of their pensions' (Hill, 2005, p.156).

With these goals in mind, this Study will examine the current system and the extent to which it is achieving these goals; suggest ways in which policy might be improved; and analyse the implications of such alterations.

Outline of the Study

As will become evident, this Study is driven by economic, moral and social imperatives. Chapters 1 and 2 comprise an introduction to pensions as both product and policy. Chapter 2 also provides a synopsis and brief analysis of the current system in Ireland.

Chapter 3 examines the theoretical framework around which pensions are based, both in Ireland and abroad. It analyses previous writing on State pension policy, examining a number of diverging views, opinions and examples. It illustrates the different ways in which countries provide for their elderly. The chapter also develops a theoretical focus that will drive this Study.

Chapter 4 proposes a change to the current system. This proposal forms the focal point of this Study. Informed by the content of the preceding chapters, the remainder of this Study analyses the implications of this proposed change, with Chapter 5 providing a detailed summary of the methodology and assumptions used in this analysis.

Chapter 6 contains details of the data used to analyse the financial implications of the proposal, as well as projections of the long-term cost of the proposal. Chapter 7 analyses the findings from these projections and discusses the implications. The Study concludes in Chapter 8 with a final discussion of the issue and some recommendations.

The Contextual Significance of the Study

The State social welfare pension cost the Irish Exchequer approximately €4.91 billion[2] in 2012 (Department of Social Protection, 2013, p.28). With social welfare spending in that year totalling almost €21 billion (Department of Social Protection, 2013, p.2), the social welfare pension represents 23.3% of all social welfare spending in the State[3]. Outside of this direct spending, the Exchequer also annually foregoes billions of euros in tax revenue via the tax relief and exemptions directed towards private pension provision.

Because of Ireland's demographic outlook, the long-term sustainability of the pension system is being called into question. Even though Ireland starts from a better position compared with the rest of Europe in terms of the relative

[2] This figure does not take into account the Widow's pension, which is not age-dependent. It is worth noting that the Widow's pension cost the state €1.34 billion in 2012, of which approximately €1.05 billion was paid to recipients over the age of 65 years (Author's calculations, based on statistics from the Department of Social Protection).

[3] Or 28.3% if one includes the amount of Widow's pension paid to people aged 65 or older.

numbers of workers to people of pensionable age, the decline in our projected support ratio is projected to be rapid and severe (Department of Social Protection, 2012b, p.6).

Given the importance of pensions as a poverty reliever, a balance must be struck between adequacy of the benefit provided and the long-term viability of the system. It is important to remember that the elderly are among the most vulnerable in society and the most susceptible to poverty in cases where there are no social transfers. McCashin (2004) confirms that 'state social welfare payments are the most significant element in older persons' incomes', and statistics will show in the following chapter just how significant they are as a poverty reliever. The system's long term sustainability will remain central to any anti-poverty strategy undertaken by government.

Finally, the Department of Finance's *National Recovery Plan* (2010, p.93) asserts that public discourse on the cost of pension tax relief has been ill-informed and 'tends to distort the expectations of the savings that could be delivered by adjusting these reliefs'. For the credibility of this Study and its proposals and in the interest of society in general it is important to have conclusive analysis of the effects of any adjustments that might be made to this tax expenditure[4], the benefits of this expenditure, and analysis of how this money could be otherwise used.

Conclusion

This Study will first ascertain whether policy objectives are being met. It will then analyse different steering visions for pension policy and select one for guidance. Based on this vision, the Study will then suggest ways of improving the current system and analyse the implications of these changes. Ultimately, the aim is to show that the system can better achieve its aims without the need for significant additional revenue raising, and that there is sufficient resources in the Irish pension system to allow every Irish person to, in the words of the United Nations Department of Economic and Social Affairs (2000, p.1), 'retire from work with dignity'.

[4] Tax relief is in effect expenditure, as it is revenue foregone by the Exchequer.

2. The Current System

A Brief Synopsis of the Current System

Ireland's pension system has two main pillars[5]; the State pension and the private pensions system. Retired people may have income from other sources, such as investments and savings, and public servants will benefit from their own specific arrangements which are funded by their own ordinary contributions and the public service pension levy, with the balance being made up out of general taxation. But the focus of this Study is on these two main pillars and how they interact.

The State Pension – Rates, Eligibility & Funding

Table 2-1 shows the weekly amounts of the various State pensions.

Table 2-1 State Pension Benefits

Summary of the weekly (top-rate) Pension Benefits payable by the State

Benefit	Amount
State pension (Contributory)	€230.30
State pension (Non-Contributory)	€219 (aged 66-79)
State pension (Non-Contributory)	€229 (aged 80+)
State pension (Transition)	€229
Widow's Pension	€193.50 (aged <66)
Widow's Pension	€230.30 (aged 66-80)
Widow's Pension	€240.30 (aged 80+)

Figures from the Citizen's Information website

Entitlement to the contributory pension is tied to labour market participation, with a minimum number of social insurance (PRSI) contributions required before the recipient qualifies for the full amount. This system results in coverage anomalies, with certain sectors in society – usually women and the self-employed – less likely to gain access to the contributory pension. The non-contributory pension is means tested.

The State Pension (Transition) is paid to people aged 65 who have retired from work and have made sufficient PRSI contributions. It is not means-tested and retirees transfer to the contributory pension at age 66. This transition pension will no longer be paid from 2014 due to the impending increase in the national retirement age (NRA).

[5] This Study will for the most part ignore the public service pension system. It stands separate from the other two pillars in that it is essentially a large unfunded occupational pension scheme. Further, negotiated reforms have been implemented for all new recruits to the service which while providing a reduced benefit to retirees remains sufficient to give an adequate standard of living in retirement. Further, the *National Pensions Framework* (Department of Social and Family Affairs, 2010, p.2) notes that the highest rate of pension coverage is in the public service at 93%, well ahead of the private sector.

The NRA is currently 65 years, but will increase to 66 from 2014. There will be further increases to age 67 in 2021 and 68 in 2028.

These benefits are paid on a PAYG basis from PRSI contributions (contributory) and general taxation (non-contributory) according to need. Ireland's demographic profile – one of a young but ageing population – means that the effectiveness of pension reform will have a huge bearing on the country's ability to finance itself in the future. With this in mind, the National Pension Reserve Fund[6] was established to fund future pension liabilities. This fund was once valued at around €25 billion but has been significantly depleted in order to recapitalise the Irish banking system (Healy, 2013), with the remainder now likely to be used to fund capital investment projects. The uncertainty over how much, if any, return the NPRF will receive means that long-term sustainability is further called into question.

Private Pensions

As well as the State pension, there exists various means for people to provide additional retirement benefits for themselves via the private pension system. The government encourages contributions to private pension arrangements by granting tax relief on these contributions within certain limits which are earnings and age dependent. Whether an individual is a self-employed person contributing to a PRSA or an employee contributing to their employer's occupational scheme, relief may be claimed on such contributions at the individual's marginal tax rate[7]. In other words an individual paying tax at the higher rate is contributing just 59 cents for every €1 paid into their pension fund, with the remainder being effectively subsidised by the State. Employers can also claim tax relief on pension contributions made on behalf of employees, and there in no Benefit In Kind tax payable[8] by the employee on this contribution (Commission on Taxation, 2009).

Private pension take-up varies across different sectors of society, and access is even more stratified than that described for the State pension. The government's *Green Paper on Pensions* found that around 32% of "pensioner units" have income from occupational or personal pensions, though relatively few pensioners in the bottom two-fifths of incomes have income from these sources. Research has shown that at the lowest income levels, membership of pension schemes is extremely low (around 1%), leaving a huge deficit in coverage among a large sector of society.

[6] Established by the government in 2000 to fund future social security and state occupational pensions, legislation obliged the State to set aside 1% of GNP annually to meet this cost (McCashin, 2004).
[7] Information regarding the different tax rates and tax bands in Ireland can be found in Appendix A.
[8] The exception here is on contributions by the employer to a PRSA.

An Analysis of the Current System

One of the key differences between pensions and other social security in Ireland is that pensions are provided by both the state *and* the private sector. How they should interact and complement each other is an important aspect of policy.

The State Pension

The State pension (contributory), to which not every elderly person is entitled, is €230 per week. This is 33% of average weekly earnings[9]. It is designed to provide a subsistence level of existence, but according to Hughes (2008, p.114), Ireland has had a comparatively high rate of pensioner poverty by international standards. Table 2-2 shows Ireland's ranking in the EU since 2005 for the 'at risk of poverty rate[10]' among people over 65 years old.

Table 2-2 Ireland's Poverty-rate Ranking Among over 65 years since 2005[11]

	2005[12]	2006	2007	2008	2009	2010	2011
Rank in EU	2nd	4th	6th	15th	18th	20th	20th
Rate (%)	32.8	26.9	28.3	21.1	16.2	10.6	11.0

Figures from Eurostat (2013)

Prior to the beginning of Ireland's economic difficulties in 2007, Ireland had one of the highest 'at risk of poverty' rates for people aged over 65 in the European Union. This rate has gradually fallen to 2011. However, there is a suggestion that poverty rates rise during economic booms, before falling away during recessions. This is a constraint of using the traditional measure of a poverty line as it is responsive to changes in the median income. It is therefore possible that pensioner poverty as presently measured may be lower than the equilibrium level, and thus understated.

Table 2-3 illustrates the findings of an OECD study (2011, p.148-149), which shows that Ireland's rate of over 65s with less than 50% of median household disposable income[13] is more than double the OECD average, making us one of the worst performing countries in the Organisation, with New Zealand the best performing.

[9] Based on average weekly earnings of €696 (CSO, 2013a, p.1).
[10] The 'at risk of poverty' rate identifies the proportion of individuals who are considered to be at risk of experiencing poverty based on the level of their current income and taking into account their household composition. It is calculated as the percentage of persons with an equivalised disposable income of less than 60% of the national median income (CSO, 2012a).
[11] Comprehensive figures are not available for the period pre-2005, making further comparison difficult.
[12] The rankings for 2005 and 2006 are for 26 nations, not 27. Statistics are not available for Romania for those years.
[13] While 50% of MHDI is not consistent with the 'at risk of poverty' measure, these figures do serve to give an interesting and worthwhile international comparison of how well each country provides financially for its elderly.

Table 2-3 OECD data for Income among the over 65s

Percentage of people aged over 65 with incomes less than 50% of median household disposable income

Country	% below 50% of MHDI
Australia	26.9
Austria	7.5
Belgium	12.8
Canada	5.9
Czech Republic	2.3
Denmark	10.0
Finland	12.7
France	8.8
Germany	8.4
Greece	22.7
Hungary	4.6
Iceland	5.0
Ireland	30.6
Italy	12.8
Japan	22.0
Korea	45.1
Luxembourg	3.1
Mexico	28.0
Netherlands	2.1
New Zealand	1.5
Norway	9.1
Poland	4.8
Portugal	16.6
Slovak Republic	5.9
Spain	22.8
Sweden	6.2
Switzerland	17.6
Turkey	15.1
United Kingdom	10.3
United States	22.4
OECD30	**13.5**

The Importance of the State Pension

Given that a stated goal of our pension system is the provision of an adequate basic standard of living, statistics measuring the incidence of poverty or risk of poverty among pensioners and the extent to which pensioners in Ireland depend on the social welfare pension must be analysed and assessed[14]. The importance of the State pension in providing an adequate standard of living for older people

[14] While the concept of adequacy will be explored further in Chapter 3. For now, this Study uses the national poverty line, set at 60% of median equivalised disposable income, as an income adequacy benchmark.

is perhaps best highlighted by the following statement from the CSO's (2010, p.37) *Survey on Income and Living (SILC) 2009*; 'The protection offered by social transfers against the risk of poverty was most evident among the older age groups. This reflects the relative importance of the state pension and other state allowances for these age groups. When social transfers were excluded, the 'at risk of poverty' rate of persons aged 65 and over was 88%. When social transfers were included this rate fell to 9.6%'.

Indeed, old age poverty is a persistent issue, though its severity has varied over time. Among all those who experience poverty, it is the retired that experience the greatest volatility in their poverty risk rates. The elderly had a higher risk of income poverty than any other segment of the population in the early 1970s before their situation greatly improved up until the late 1980s. However, 'the position of the elderly population worsened dramatically' from 1987 to the late 1990s (Fahey, Layte & Whelan, 1999). From 1994 to 2001, the rate of poverty has ranged from 5.9% to 44.1%, dipping again to approximately 11% in 2011.

Table 2-4 Percentage of people 65 years+ with below 60% of the median income

Year	1994	1998	2001	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rate (%)	5.9	32.9	44.1	39.5	38.0	32.8	26.9	28.3	21.1	16.2	10.6	11.0

Figures from Fahey, T., R. Layte & C. Whelan (1999) and Eurostat (2013)

The significant fall since 2004 coincides with the large increases in the social welfare pension over the period, and highlights the importance of the social welfare pension as a poverty reliever. If our society values the reduction and eventual elimination of poverty, particularly among our most vulnerable citizens, it is clear from the above that a social welfare pension at a level capable of sustaining a person will be *the* central factor.

Taking into account the evidence from Hughes, the OECD, the SILC data and Eurostat, we can discern that social welfare payments play a key role in *reducing* poverty among this group, but do not achieve the *elimination* of the risk of poverty for them. Assuming the aim is to reach zero poverty in old-age, or close to it, current policy is still coming up short.

There are also some inequality issues when it comes to access to State pension benefits. Many self-employed people have no access to a pension, while there is also a major gender inequality issue when it comes to pension coverage in Ireland. Women are less likely to have independent access – as opposed to through their husband's PRSI contributions – to the State pension, largely as a result of irregular work histories (National Women's Council of Ireland, 2008). While some steps have been taken over recent years to address gender-related issues[15] this has not solved other problems caused by the fact that 'much of "women's work" is typically poorly paid and offers poor conditions of

[15] For example, since 1994, time spent working in the home has been disregarded for the purposes of calculating yearly average contributions (McCashin, 2004, p.258).

employment – for example, it may be seasonal, non-pensioned, insecure, offering short-term contracts or piecework' (Duvvury et al, 2012, p.28).

Private Pensions

Private pension provision usually comes in the form of occupational pension schemes through one's employment, or personal pensions (e.g. RACs, PRSAs) for people who do not have access to occupational plans. As mentioned previously, the government encourages participation by granting tax relief at the marginal rate on contributions to such plans, within certain age and earnings-related limits.

There is plenty of evidence to suggest that the existing tax relief arrangements for pensions are both expensive and heavily biased in favour of those who pay tax at the higher rate. While calculations vary, it has been estimated that they cost the Exchequer €2.9 billion[16] in 2006 (Department of Social and Family Affairs, 2007, p.106) and €2.75 billion in 2010 (Stewart, 2011) in revenue foregone. The ESRI (2009) notes that studies in the United Kingdom and United States indicate significant deadweight loss associated with tax incentives for pensions, with such incentives often acting to subsidise savings that would take place anyway, especially amongst high earners.

It is a fact that the current system is failing to deliver on coverage targets. The National Pensions Policy Initiative (Pensions Board, 1998, p.11) stated the aim as being that by 2008, 66% of working people aged 30-65 would have supplementary coverage, and ultimately 70% would have some form of private coverage. Though this was never formally adopted as government policy, it is worth comparing this goal to current coverage rates.

According to the OECD (2013, p.48), the latest available data indicate that at the end of 2009, only 58% of workers aged 30-65 were enrolled in private pension plans, which is 12% below the NPPI's target. Broadening the sample to workers aged 20-69, the coverage rate is even lower at 51%. This represents a fall as compared with 2008 Q1 (54%) and 2005 Q4 (56%).

The OECD data includes public sector workers, and therefore falls outside the scope of this Study. Focusing only on funded private pension plans, coverage falls even further. At the end of 2009, only 41.3% of private-sector workers aged 20-69 were enrolled in a funded pension plan, either occupational or personal.

Even for those with private coverage, the system often does not perform to expectation. Despite such generous tax treatment – which also includes tax free investment returns and a tax free lump sum payment on retirement – private pensions often do an inadequate job of providing retirement income, and with the current trend of employers moving from Defined Benefit to Defined

[16] This figure encompasses *all* tax, PRSI and health levy relief of employee and employer contributions to occupational schemes, personal pensions and PRSAs, as well as BIK allowances and tax foregone on tax-free lump sums. It is offset by the tax yield from payment of pension benefits. PRSI and levy relief has since been abolished.

Contribution schemes[17], this is unlikely to improve. Members of Defined Contribution schemes are often left at retirement with inadequate pots with which to purchase annuities, while even Defined Benefit plans are not providing as promised, with the Society of Actuaries in Ireland (2008) acknowledging that 'as far as Defined Benefit pension schemes are concerned, the current pension system over-promises and under-funds and scheme members (especially current employees) are exposed to far greater risks than are commonly understood'.

Box 2-1 Defined Benefit versus Defined Contribution – An Explanation

Defined Benefit plans generally offer employees a guaranteed annual pension, based on their company service and their salary at retirement. Typically, a retiring employee might get 1/60th of their salary (or pensionable salary, which might include an offset for the State pension) for every year of employment.

The benefits from Defined Contribution plans are based on the contributions paid, their investment return and the annuity rate at the time of retirement, and therefore offer much less certainty to employees. They are also far more risky for employees than DB Plans as low contribution rates, poor investment returns, and the increasing cost of annuities means that they often provide inadequate benefits when the employee retires.

The trend towards Defined Contribution schemes in recent years has been driven in part by the desire of employers to reduce and bring certainty to the cost of pension schemes. This has resulted in an effective transfer of risk from employer to employee.

According to the OECD (2013, p.30), since December 2007, there are more people enrolled in DC schemes than DB in Ireland.

From the point of view of the Exchequer, the generous tax exemption limits and the structure of our pension system means that much of the tax foregone on pension contributions and investment gains is never recovered, even upon retirement. This has led to our EET system of pension taxation more closely resembling an EEE system, where effectively little tax is paid[18]. This is exacerbated by the fact that many individuals who have received relief on their contributions at the higher rate are taxed at the lower rate on their retirement income, and may avoid tax altogether if they are eligible to take their benefits in the form of a tax-free lump sum.

Finally, the gender equality issue which pervades the first pillar is prevalent in the second pillar too. Women comprise a majority of the older population in

[17] This trend is broadly in line with that of other OECD countries (OECD, 2013, p.30). See boxed text 2-1 for an explanation of the difference between Defined Benefit and Defined Contribution.

[18] An EET system is one in which the employer and employee contributions to a pension fund are exempt (E) from tax, the investment income and capital gains are also exempt (E) from tax and the pension benefit is taxed (T) in payment. An EEE system is one in which all three components are exempt from tax (TASC/Trinity College PPRG, 2008, p.25).

Ireland (CSO, 2012b; National Women's Council of Ireland, 2008). However, membership of occupational pension plans is higher for men than women. This just compounds the problem discussed earlier in relation to women accessing the State pension, with the irregular work histories of some women that preclude them from accessing the State pension excluding them from employment-based pension provision also. TASC (2010) agree that women are 'particularly disadvantaged by both the State and private pension systems because they provide most of the care required by children and elderly relatives. This means their work histories are more irregular than those of men, and it is more difficult for women to qualify for either a State or a private pension'.

It is also the case that individuals (mainly women) working in the home or in unpaid caring roles cannot benefit from the tax reliefs being used to incentivise retirement savings for working individuals.

The System in Summary

- Ireland has an above average rate of poverty amongst the elderly, performing poorly relative to other developed nations.
- Ireland's pensioner poverty rates fluctuate, although there has been a gradual improvement over the past decade, thanks mainly to State pension increases.
- Gender inequality affects access to both pillars of the system.
- The private pension pillar does not do an adequate job of increasing coverage, and the tax arrangements that support it benefit the richest in society most.
- The system's objectives are not being met.

Census 2011 noted 531,600 people aged 65 and over in Ireland (CSO, 2013b). That same year, according to the *Statistical Information on Social Welfare Services 2011* (Department of Social Protection, 2012a) there were 405,800 receiving the State pension, plus 85,000 recipients over the age of 65 receiving Widow's/Widower's pension. This leaves over 40,000 people over the age of 65 in receipt of no pension from the state. Meanwhile, Eurostat (2013, p.91) calculated that there were 60,000 people over the age of 65 living in poverty in Ireland in 2011; a number that has traditionally been higher.

Conclusion

It is clear that although Ireland spends a lot of money on its pension system, it is failing to achieve its objectives. We must therefore ask the question, how can the system be changed in order that these objectives are better met? This is the challenge posed to this Study, and one that will now be addressed.

3. Theoretical Framework & International Comparisons

Introduction

In order to form a guiding ethos for this Study, this chapter will analyse the different philosophical and political perspectives on the purpose of pensions. As part of this exercise, criteria for measuring the success of a pension system will be defined. The body of work analysed includes governments, academics, economic research bodies and industry representatives. Space constraints dictate that we cannot examine all view points and system models, but effort has been made to see that a representative sample has been studied.

As already noted, the *Green Paper on Pensions* (2007, p.3) states that the primary goal of the system is to ensure that people have an adequate income in retirement. More specifically, 'the overall objective of our pension 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'. Long term sustainability and modernisation are also noted goals. Such ideals remain relevant, regardless of the changed economic circumstances since publication. Therefore this Chapter will also concern itself with defining an adequate standard of living for the elderly, and advancing the argument for reaching it.

Pensions as a Reliever of Poverty

Rawls and Fairness

This Study has thus far assumed that the elimination of poverty and the creation of a more equal society should be an aim of government. Liberal egalitarians would aim to regulate inequality 'by combining a minimum floor or safety net with the principle of equal opportunity' (Baker, 2006, p.29). Quite where the floor should be is an enduring debate.

On the other hand, Rawls (1971; 2001) accepted that there would be inequality in society. However, he believed that these inequalities should exist only to the extent that they benefit the least advantaged. An interesting situation to consider in the context of this discussion is the *Original Position* as described by Rawls; individuals are asked to consider the political and economic structure of the society in which they will live. However, they do so behind what Rawls called a "veil of ignorance"; each lacking the knowledge of what his or her circumstances will be in this society – gender, age, ethnicity or abilities. Rawls argued that each individual will attempt to make the least well off in society as well off as possible in case that should be the level which they themselves occupy.

It is difficult to argue against the idea that (a) an individual would not seek to maximise the attainment of the least well-off in society if there were an equal chance that it should be they, or that (b) given this, society should *not* seek to alleviate the position of those living in poverty. It is these assumptions that form the first basic tenets of the theoretical framework of this Study.

Definition of Poverty

In Ireland, the poverty line is defined as 60% of median household income. This is obviously a relative concept[19], as the line is set relative to incomes in society at a given time. In this regard the government treats pensioners exactly the same as other individuals in society when defining and measuring poverty. Both a pensioner household and a working-age household are considered to be poor if their income falls below the same threshold. Moreover, this threshold is defined relative to the incomes of everyone in society, both young and old. 'This approach implicitly embodies a view that there should be a degree of equality between young and old in society. If pensioner poverty was defined relative to the incomes only of pensioners, then it is possible that pensioners as a whole might fall behind the working-age population. By setting a common standard, there is a presumption that the living standards of pensioners should not be left behind compared to those of the working-age population' (LeGrand, Propper & Smith, 2008, pp.75-76).

According to Social Justice Ireland (2013, p.84) the income poverty line for a single adult is €213.67 per week in 2013[20]. This is sufficient to bring one above the poverty line. But how much is "enough" income? And more precisely, what constitutes "enough" income in retirement?

The Minimum Income Standard

As noted in Chapter 2, there is a suggestion that poverty rates rise during economic booms, before falling away during recessions. This is a constraint of using the traditional measure of a poverty line as it is responsive to changes in the median income. It's possible that pensioner poverty as presently measured may be lower than the equilibrium level, and thus understated.

Collins, McMahon, Weld and Thornton (2012) have published a comprehensive work on minimum income standards in Ireland[21]. *A Minimum Income Standard for Ireland* calculates €262.64 per week as the amount required by a female pensioner, aged 70+, living alone in an urban setting, to have 'a minimum essential standard of living' (MESL). Their publication expands on the idea of poverty lines and measures of deprivation already widely in use in Ireland by measuring the amount of expenditure required by different types of households for what is considered in this country to be a minimum standard of living.

[19] Whatever income benchmarks there are, they must be relative – it is hard to intuitively justify a static measure of living standards in a dynamic society (Collins, 2008, p.99).
[20] This is derived from the CSO's figure for 2011, updated to 2013 using the ESRI's predicted changes in wage levels.
[21] Further information on this publication is detailed in Appendix B.

This Study feels that the use of the female pensioner described above as the standard for a minimum income requirement is appropriate for purpose, and notes the following points;

1. The amount required by a pensioner to achieve the MESL is more than €100 per week lower in an urban setting than in a rural one. One could therefore consider €262.64 per week as being a conservative estimate of the amount required to sustain an older person in Ireland.
2. As older women have been shown to be more at risk of poverty than older men, as well as more dependent than men on the State pension, if we must choose one gender for this benchmark it is appropriate that it be female.
3. Though pensioners aged 66-69 are also used as a case-study by the MESL data, the fact is that there are more than twice as many pensioners in Ireland aged 70 or older than there are under 70 (Department of Social Protection, 2013, Table B5; CSO, 2013b, Table 1); again making this selection more appropriate.

This Study will use the above Minimum Income Standard as a benchmark for income adequacy in retirement.

Different Perspectives on Pensions

We have already briefly analysed the ideas of Rawls on equality, and tried to ascertain what he might have made of the topic at hand. Let us look now at some other theories on pensions.

The Corporate Perspective

Pricewaterhouse Coopers, Ireland's largest professional services firm, provide the following definition; 'Pensions are simply another form of investment. In addition, they have very attractive taxation benefits which make them a very lucrative investment' (Pricewaterhouse Coopers). This mindset is prevalent in certain circles: a tax-efficient investment to be made use of by those with the financial capacity. This attitude – along with the income and corporate profile of PwC's main clients – illustrates something that no shortage of studies[22] have shown; in the case of private pension arrangements, it is the better off in society who can most afford to contribute to private pension arrangements, and so benefit most from the generous tax treatment afforded them.

Yet this runs contrary to the principles upon which the system purports to operate. The Green Paper states 'that the object of tax relief must be to incentivise and support those less able to make adequate pension provision and not necessarily to subsidise those who are in the strongest position to do so' (Department of Social and Family Affairs, 2007, p.108).

[22] See for example ESRI (2009) *Pension Policy: New Evidence on Key Issues*

The government has subsidised private pension arrangements through generous tax reliefs for a number of years in a manner broadly in line with the wishes of those advocating a greater role for the private sector in retirement benefit provision. It must now be asked whether this is agreeable from the point of view of equity, adequacy, and sustainability.

Neoliberalism

Steger and Roy (2010, p.14) summarise neoliberal policies using the DLP formula: deregulation, liberalization and privatization. Such a philosophy advocates shifting the emphasis from the public sector to the private. Indeed several economists, particularly of the Chicago school in the 1970s and 1980s, have made strong arguments for the virtues of market-based pensions over public provision. These theories were put into practice in the form of the wholly market-based pension system introduced in Chile in 1981.

Reports highlight a number of criticisms of the system adopted in Chile; among them the high – and rising – administration costs and the potentially costly state guarantees that back up the private system (OECD, 1998). The system has also resulted in declining coverage rates.

Even Sebastian Piñera[23] has criticised the system as it was instituted, saying 'half of Chileans have no pension coverage, and of those who do, 40% are going to find it hard to reach the minimum level' (Rohter, 2006). The UN Economic Commission for Latin America concurs, saying 'the bottom line is that this system does not work with this labour market' and that if trends continue 'only a small percentage of people are going to be able to finance meaningful pensions' (Rohter, 2006). The OECD (2009a, p.30) deems that expectations regarding coverage resulting from the reforms have not been met, with coverage levels lower than those reached under the previous system.

The financial costs too have been substantial. Though the system is still in transition phase, the conversion has had major fiscal implications. In term of revenue flows, the government faced a sharp decline in revenue due to income that moved to the new system, while it fully funds entitlements build up in the old system. The cost of transition has ranged from 4.1% of GDP to 8.3% of GDP per annum, while the OECD expects that as well as creating a moral hazard, the minimum pension guarantee will pose a large fiscal risk, something that the system was intended to avoid (OECD, 1998, p.11).

This experiment is a perfect example of how the "privatisation" of retirement, aimed at stabilizing public finances, does not necessarily solve the larger issue of providing an adequate income to the elderly. Nor does it solve the issue of allocating the costs of population-ageing between or within generations. Meanwhile the cost of "transferring" this off the national budget (i.e. the cost of pension tax reliefs, and potentially transition costs) is very expensive.

[23] Mr. Piñera is the conservative President of Chile and the brother of José Piñera who instituted the 1981 pension system.

The Irish Government

In its 2011 election manifesto, Fine Gael stated its intention to 'fundamentally reform' the pension system to set Ireland on a path to achieve universal coverage, more generous supports for the lower paid, greater equity, lower costs and lower risks for individual savers (Hughes & Stewart, 2011, p.3).

The Labour party has heavily criticised the current system of tax relief in the past, saying in September 2008 that if the Government (of the time) was looking at saving money 'then surely immediately capping this grotesque tax incentive scheme or scrapping it altogether in favour of a much fairer system is an obvious place to start' (Labour Party, 2008). Yet to date, the most notable reform of the current government has been to reduce the Standard Fund Threshold to €1.5 million (from €2.3 million).

Fine Gael, the senior coalition partner in the current government, believes that reducing the tax reliefs available on pensions would destroy the incentive for middle income families to save for retirement, and is instead content to impose a cap on the amount that can be accumulated with such reliefs. €1.5 million would purchase a pension for life of €75,000[24], hardly in keeping with a desire to assist those on lower incomes. It is clear from this that the current government is content to assist the well-off save for retirement using tax incentives at the expense of people in real need of this money.

In recent Budgets, there have been reductions in the level of salary that can be taken into account for tax relief on contributions to occupational pension schemes, progressively from €254,000 per annum to €115,000 (though this was under the previous Fianna Fáil-led government). There is also a cap on relief for pension contributions to funds that will pay out a pension in excess of €60,000 per annum. However, the curtailments of pension-related reliefs in the last five years have been made not with a mind to modernise the system but are motivated by the Exchequer's current financial situation. This is short-sighted and fails to address sufficiently the failures of the system as a redistributor of income.

The *National Recovery Plan* (Department of Finance, 2010) stated an intention to reduce the reliefs over the course of the Plan; specifically that the rate of income tax relief on pension contributions would be reduced from 41% to 34% in 2012, to 27% in 2013 and 20% in 2014. These changes were never implemented; something that may say something about the extent to which governments are beholden to the Irish pensions industry[25]. It certainly doesn't highlight any commitment from the government to its supposed goals regarding pension reform.

[24] This figure is based on Irish Life's online annuity calculator at 25 July 2013. Quotation for a male aged 65 years, paid monthly in advance.

[25] In modern industrial society, it is difficult for governments to operate without the specialised knowledge of interest groups. By providing expertise, interest groups have an opportunity to directly influence government policy (Haralambos & Holborn, 2000, p.595).

The Issue of Tax Reliefs

Several organisations, among them Social Justice Ireland, TASC and the Trinity College Pension Policy Research Group (TCD PPRG), have for years been advocating a reduction in the tax reliefs afforded pension contributions in Ireland.

TASC and the TCD PPRG published a response in 2008 to the Green Paper stating that it would be possible to virtually eliminate pensioner poverty using savings in private pension tax relief if the government reduced the rate of relief from the marginal rate to the standard of income tax (TASC/Trinity College Dublin PPRG, 2008, p.32).

Social Justice Ireland and Hughes also make a strong case for a universal pension funded by a reduction in tax reliefs (Hughes, 2008). They reiterate that most of the benefits of the tax reliefs in Ireland have been appropriated by the highest earners (p.141) and point to the New Zealand system as an example which Ireland could follow. Indeed, Table 2-2 highlights the fact that New Zealand is the highest achieving country in the OECD when it comes to reducing pensioner poverty, while spending very little on tax reliefs for private pensions. This system will be further analysed in the next section.

An ESRI (2009) report predicted that the standardisation of relief on all pension contributions (employee, employer and implicit government contributions) at the standard rate could raise revenue of over €1 billion per annum. Only those earning enough to pay the higher rate of tax would be affected, while more than four-fifths of revenue raised would come from the richest one fifth. While these figures may have changed in the years since, this does serve to highlight the expense to the tax-payer of the current system of reliefs.

International Comparison

There are many different pension systems in the world. Space constraints dictate that we may only look at a few, and even then, not in great detail. The following are examples of the many different things that governments can do with their systems based on different objectives and spending constraints.

Earnings-related State Pensions

The German state pension is different to Ireland in that it is designed as a system of earnings replacement, rather than as a flat social insurance payment or as protection against poverty in old age. It pays a pension roughly proportional to the individual's labour income averaged over their life, something that has been noted to make it much more generous to high earners than to low earners (LeGrand, Propper & Smith, 2008, p.82).

During the early part of the 2000s, Germany passed several Acts designed to strengthen the second pillar of the pension system 'in order to compensate for expected reductions in benefit generosity due to the weakening of the public

pillar'. The *Sustainability of Pensions* law (2003) linked benefit increases to developments in life expectancy and the employment rate[26] (Busemeyer, 2006, pp.403-404). Concerns that the contribution rate required to maintain these pensions will more than double by 2050[27] have led to reforms to reduce the benefits being paid and to encourage private pensions.

The system of the United Kingdom might be seen as a mix of Ireland and Germany. The first tier consists of a flat-rate Basic State Pension paid to those with sufficient years of contributions. It is operated on a PAYG basis and uprated annually in line with inflation. There is also a second tier provision known as S2P, designed as a method of earnings replacement, but individuals can opt out into a private pension with contributions to such arrangements encouraged using tax incentives.

Like Germany, the UK system operates on the principal that the State has a responsibility to replace some level of pre-retirement earnings. However, these countries illustrate that one of the greatest contributing factors to unsustainability of pension systems is the acceptance of responsibility for maintaining living standards at the Exchequer's expense. This is a problem not faced by the Irish system, leaving Ireland in a much better position fiscally than many other nations.

Mandatory Enrolment

Mandatory enrolment in supplementary private pension arrangements is one way to expand coverage. One example of this is the Australian system, which consists of a flat-rate means-tested benefit known as the age pension, and a mandatory occupational savings pension known as the superannuation guarantee (LeGrand, Propper & Smith, 2008, p.82).

One noted aspect is that the means-tested element encourages the spending down of assets to allow qualification. However, coverage rates are quite high, as superannuation covers over 90% of employees, and employers contribute 9% of earnings to individual accounts with supplements from the government for low-income workers and tax relief to encourage voluntary top-ups.

However, like almost all systems which use tax incentives, the majority of the benefits are appropriated by high earners, while those on lower incomes receive comparatively little benefit, including those who work in caring roles or in the home (Hanegbi, 2010). Denniss[28] argues that not only is it hard to imagine a less equitable way to distribute taxpayer money, but the system also encourages tax avoidance among higher earners. 'The full horror of this flawed system, however, is not its inequity but its fundamental failure to achieve its stated goal of taking pressure off the Commonwealth budget by reducing outlays on the age pension. A dollar spent on tax concessions for super[annuation] simply does not lead to a

[26] Increases in life expectancy and rising unemployment leads to lower increases in pension benefits.
[27] Projected to increase from around 19 per cent of wages to nearly 40 per cent by 2050 (LeGrand, Propper & Smith, 2008, p.82).
[28] Dr Richard Denniss is executive director of The Australia Institute, a Canberra-based think tank.

dollar's reduction in the cost of providing the age pension, now or in the future. It doesn't even come close' (Denniss, 2012).

Universal Pension

It has been already pointed out that New Zealand has an excellent record among OECD countries in the alleviation of old-age poverty. Given New Zealand's and Ireland's similarities regarding population and economy, the country provides an important case-study.

The New Zealand system consists of a flat rate State pension known as Superannuation, paid to all citizens subject to residency criteria, and a voluntary private system that prior to 2007[29] was not subsidised through the tax system.

Figures from prior to 2007 (OECD, 2005, Fig.1; Fig.5) show that New Zealand had the lowest net tax cost per unit of contribution to private arrangements in the Organisation, while simultaneously achieving an excellent record of poverty relief amongst the elderly. St. John (2003, p.22) notes that since the institution of the current system in New Zealand, 'problems of poverty among the aged virtually disappeared'. This was achieved via the universalising of the State benefit – New Zealand replaced income-tested benefits in 1977 – at a level about two-thirds of average earnings (Hughes, 2008). This admittedly resulted in an increase in direct public expenditure on the pension system but with no tax expenditure, this was deemed to be both affordable and sustainable.

Other International Comparisons

The OECD's recent *Review of the Irish Pension System* (2013, p.19) has noted that both Canada and the Netherlands combine among the lowest rates of income poverty in the Organisation with among the lowest public pension expenditure. The report notes that the key to explaining this is greater redistribution within public provision of retirement incomes; something that Ireland's current system of tax relief acts against. However, further analysis shows that the assertion of low public expenditure is a misnomer. With regard to tax expenditures, both Canada and the Netherlands rank amongst the highest in the OECD in terms of the net tax cost per unit of contribution to private arrangements (OECD, 2005, Fig.1; Fig.5), significantly ahead of Ireland, and even further ahead of countries such as Luxembourg and New Zealand. In Canada, the low level of old-age poverty is mainly a result of the relatively high level of safety-net benefits provided in Canada, through the basic pension (OAS) and the means-tested guaranteed income security (GIS) (OECD, 2009b); in other words, through direct state expenditure.

[29] In 2007, the KiwiSaver account was instituted.

Conclusion

'Liberal dogma and contemporary economic theory want us to believe that the state is an artificial creation and that the market, if left un-tampered with, is the only institution truly capable of furnishing our various welfare needs. This may be true for automobiles, but it certainly is not true for social security' (Esping-Andersen, 1990, p.75). Analysis shows that pension systems have better success alleviating and eliminating old age poverty using direct expenditure, rather than tax incentives to encourage private pension take-up which serve primarily to subsidise the retirements of the wealthy.

Meanwhile, we have identified €262.64 per week as the minimum expenditure required for a pensioner to meet the Minimum Essential Standard of Living in Ireland. One thing is already clear; this is approximately 14% above than the current weekly rate of the state contributory pension.

As noted in our conclusions on Rawls and his theories of fairness, society has a duty to relieve poverty among its most vulnerable, and governments have a duty to find the most fair and equitable way to do so. Senior OECD Economist Adema (2010, p.41) has shown that 'gross public expenditures are effective in reducing poverty, while private social expenditures have the opposite effect'. It is on this basis that we now proceed.

4. The Proposal

Introduction

The *Green Paper on Pensions* treats the problems facing each pillar separately, failing to acknowledge the reality of two pillars supporting the same system with a combined cost to the Exchequer as a whole. Table 4-1 shows the total cost of Ireland's pension system, a cost projected to rise with the changing demographic profile of the country.

Table 4-1 Total Net Cost of the Current System

Expenditure Type	Amount
State pension payments to those over 65 years old	€5,945 million[30]
Tax reliefs to private pension arrangements	€2,479 million[31]
Total	**€8,424 million**
Total as a % of GDP	**5.29%[32]**

The main effects of the current system can be summarised under three headings.

As a poverty reliever: the system has proved successful. Yet incidence of old-age poverty in Ireland is *still* high by international standards.

As a redistributor of wealth: The system acts to subsidise the retirement of the better-off in society, whilst not providing sufficiently in retirement for those on lower incomes.

Finally, there is a **large cohort of people excluded** from access to pensions; the self-employed in the case of the State pension, and women in the case of both pillars.

We have analysed the system and discussed many different viewpoints on pensions. Regardless of opinion or ideology, it should be clear that the system is capable of performing better. As outlined in Chapter 1, the purpose of this Study is to propose an alternative way of doing things, and to analyse the implications of this proposal. We must acknowledge that we are not starting from a blank slate. The proposed change will not be a huge departure from the current system. As noted by Myles and Pierson (2001), large sunk costs in existing pension institutions make 'regime jumping' difficult and unlikely for both economic and political reasons. With no *tabula rasa*, we seek to tweak rather than to overhaul. The aim, as Myles (2002, pp.134-135) has pointed out, is 'to manage the transition to achieve intergenerational fairness, intragenerational solidarity and

[30] See Table 6-3 for an explanation of this figure.
[31] This is the estimated figure for 2010. For a breakdown of this figure, see Appendix C.
[32] Based on an estimate for GDP of €159.125 billion in 2012 (Department of Finance, 2012, D.9).

gender equality while at the same time creating conditions for a strong economy and sound public finances'.

The Proposal

In developing a proposal to improve the performance of the pension system, this Study draws on the following principles;

(i) The State pension should continue to be the fundamental basis of the system.
(ii) The system should be made fairer and more equitable.
(iii) Proposals for pension reform must be affordable and sustainable.

This Study proposes a Five Point Plan for reform of the Irish pension system.

Box 4-1 The Universal Social Welfare Pension

1. Standardise the rate of tax relief on pension contributions at 20% for all income bands.
2. Reduce from €115,000 to €80,000 the earnings which may be taken into account for relief on pension contributions.
3. Increase the State social welfare pension to a flat-rate €263 per week.
4. Universalise pension coverage, subject to a residency condition.
5. Break the tie between PRSI contributions and pension entitlements; pay pensions out of general taxation.

This pension, which will replace all State pension payments to those over the national retirement age, will be referred to throughout the Study as the Universal Social Welfare Pension (USWP).

The OECD (2013, p.151) recommended the institution of a universal basic pension or a means-tested basic pension, financed by taxes, contributions or a combination of the two. Compared to the existing system, it would have the advantage of being simpler, more transparent and less costly. The OECD describes a universal basic pension scheme for the entire population which would be based on residency, providing a single flat-rate benefit and covering all of the Irish population, regardless of life-time work or contribution status. The USWP meets these criteria.

Under this system, all non-monetary benefits for the elderly would continue to be paid, including Fuel Allowance, Rent Supplement, Mortgage Interest Supplement, Respite Care Grant and the Free Travel Pass.

Aims of the Proposal

The Universal Social Welfare Pension aims to deliver under a number of headings, each of which is discussed below.

Equity

Tax expenditures on pensions are larger than any other element of tax expenditures in Ireland (Cahill & O'Toole, 2006). Yet such expenditures have been shown to be regressive by the government's own Commission on Taxation. Recommendation 8.3 of the *Commission on Taxation Report* (Commission on Taxation, 2009, pp.240-241) was that 'in general, direct Exchequer expenditure should be used instead of tax expenditures'. The report justifies this by asserting that 'to the extent that the beneficiaries of tax expenditures are those with higher incomes or substantial capital, this results in a transfer of financial resources to these beneficiaries by the rest of the taxpaying community, including those on low income[33]. In other circumstances, tax expenditure not replaced by increased taxation may lead to reduced public expenditure on essential projects'.

By standardising the rate at 20%, every taxpayer receives relief at the same rate, regardless of income. This removes the anomaly where those paying tax at the marginal rate benefit to a much greater extent than do lower earners paying tax at the lower rate. Capping at €80,000 the earnings that may be taken into consideration for tax relief on pension contributions brings even further equity to the system, while leaving the earnings cap in excess of double the average wage.

Standardising the rate of relief rather than abolishing reliefs altogether leaves incentive for people to save for retirement and to do so in a tax-efficient manner. This Study acknowledges the desirability for people to be able to replace a percentage of pre-retirement earnings in order to maintain a similar standard of living in retirement. However this should not be done at the expense of other taxpayers and the State's ability to provide adequately for everyone else. This Study also recognises the strong attachment to work-related pensions in Ireland, and believes that reducing, rather than abolishing the rate of relief is a much more politically viable move.

Poverty

Despite the relatively successful job currently being done by the State pension in relieving poverty amongst the elderly, Eurostat (2013, p.91) calculated that there were 60,000 people over the age of 65 living in poverty in Ireland in 2011. Setting the State pension at €263 per week and universalising it subject to a residency condition would immediately eliminate both these situations, while also ending once and for all the scenario where the elderly have had the most dramatically fluctuating poverty rates of any demographic in Ireland.

Real-Value Protection

There is clearly a need to link the State pension to some index in order that it does not devalue in real terms with the passing of time. One option is to link it to

[33] This assessment is backed by Fahey (2010, p.13), who concluded that such tax breaks are incapable of being progressive as they 'are of benefit only to those earning taxable income – and usually the more taxable income they earn, the greater the benefit they can derive from these measures'.

the CPI. However, the CPI is limited in use in that it does not produce indices for key subgroups of the population – such as the elderly – whose spending choices are often much different from those of the rest of the population.

A study in the United States (Federal Reserve Bank of New York, 2003) confirms that the overall CPI does not give a good indicator of how price rises affect the elderly as their "basket of goods" often differs greatly from that of the average worker. For example, the elderly spend much more of their income on medical treatment[34], so are susceptible to the effects of any major rise in costs in this area. Meanwhile, 'each of the other major categories has a smaller weight in the CPI-E[35]— in fact transportation, education, and food have substantially smaller weights for the elderly'.

The Minimum Income Standard data is updated annually by the Vincentian Partnership for Social Justice, using the CPI as the basis for this increase. However, because the "basket of goods" is related directly to the cohort of the population being addressed, tracking the increase in the cost of living for the elderly is much more precise. Furthermore, the elements included in the data are updated every few years to reflect the fact that the requirements to achieve the MESL change over time. Therefore, this Study suggests the USWP be tied to the Minimum Income Standard.

Universal Coverage

Expanding coverage is an aim referred to repeatedly in the Green Paper and in many Pensions Board reports. One would expect that the generosity of the tax reliefs available on pension contributions to private arrangements would lead to high levels of coverage in Ireland, but that has not been the case. In fact OECD evidence referred to in Chapter 2 suggests that coverage levels have been decreasing[36]. Combined with the aforementioned trend from DB schemes to DC, the result is a further decrease in certainty of the retirement income the private sector might provide. It should also be noted that many of the individuals categorised as "covered" by private sector pensions are covered for inadequate amounts.

The universalisation of the State pension is the quickest and most efficient way to expand pension coverage in Ireland. According to the Green Paper, approximately 88% of the population were covered by social welfare pensions in 2006, and this is expected to rise to 98% by 2056 (Department of Social and Family Affairs, 2007, p.69). Clearly, universalisation is inevitable, so this aspect of the USWP is not the huge departure from current policy it might at first seem.

[34] Admittedly the cost of medical care differs greatly in the United States and Ireland, though it is still true that the elderly in Ireland spend proportionately more of their income on medical treatment.
[35] The CPI-E being the notional CPI for the elderly.
[36] This Study acknowledges that the absolute numbers of people covered by private pension arrangements has risen over the period being measured. However, coverage rates have failed to keep up with the growing labour force, and with the overall proportion of people covered falling, it should be clear that the private pension system is failing in its task to expand coverage to a majority of individuals.

The New Zealand Superannuation provides flat rate benefits at age 65 to all New Zealanders living in New Zealand who satisfy the requirement of 10 years residency since the age of 20 and not less than 5 years residency since the age of 50 (Hughes, 2008, p.111). This study proposes a residency condition similar to this, with the proviso that this pension be payable to long-term residents who are not necessarily citizens. Resident non-nationals contribute both socially and economically to this country; those who have chosen Ireland as their home should not be excluded from the system.

The only excluded category should be pre-April 6th 1995 public servants, as their occupational pension schemes are not integrated with the social welfare pension, and they are therefore deemed to be in receipt of an adequate pension from the Exchequer without need for additional payment. Where this is not the case and the payment is below the level of the USWP, these former public servants should receive a supplement to bring them up to the level of USWP.

Gender & Pensions

As illustrated earlier, the pension needs of women differ from those of men. Studies show that older women are particularly vulnerable to poverty (Fahey, Layte & Whelan, 1999: National Women's Council of Ireland, 2008), due in great part to issues of access to the State pension. As previously noted, irregular work histories are at the root of this. The NWCI has pointed out that if the State pension is not adequate it is women who lose relatively more than men as they are more likely to be reliant on it. However many women had no option but to leave the workforce upon marriage and motherhood, given insufficient childcare facilities, unequal pay and tax arrangements. This is not to mention the marriage bar which forced many women to leave employment upon marriage. Many women are now being penalised a second time for this unjust and discriminatory practice.

Even women working in the home voluntarily can be seen to be being treated unfairly, given that they provide the socially (and economically) necessary role of care-giver through their working-age years, only to find themselves with no access to any State benefits in retirement, except perhaps through their spouse.

Universalising the State pension would remove this anomaly, which is only justifiable if one takes the view that the only kind of work that is of benefit to the State is the kind for which one is remunerated. 62.25% of care workers[37] are female (Social Justice Ireland, 2011, p.132-133), while there is also an obvious gender imbalance in stay-at-home parents who do the socially important job of raising children. However, the unpaid nature of this socially and economically necessary[38] work has historically led to issues with female eligibility for State benefits. A universal pension, subject to residency criteria, would remove the anomaly whereby people who work in the home find it difficult to access a

[37] By which we mean people who provide care for sick or disabled family members or friends.
[38] According to the Carer's Association (2011, p.7), people caring full-time for the elderly and people with disabilities are saving the state approximately €2.5 billion per year.

pension in old-age. It would also achieve what the NWCI has referred to as "retrospective pensions justice" (National Women's Council of Ireland, 2008, p.4), removing the gender discrimination inherent to the social welfare pension. 'The stronger the first tier of pensions, the lower the level of poverty and the greater the access women have to an independent pension in old age' (National Women's Council of Ireland, 2008, p.5). Universal benefits would help modernise the State pension system by ending gender discrimination.

PRSI and Pension Entitlements

This Study contends that the right to adequate retirement income should not be contingent on one's PRSI history and the implicit requirement of long-term participation in the formal labour market. The USWP severs the connection between State pension entitlements and labour market participation.

The *Actuarial Review of the Social Insurance Fund* (Department of Social Protection, 2012, p.6; p.37) predicts that pension-related spending, which made up approximately 60% of SIF spending in 2012, will increase to 70% as early as 2020, and eventually 85%. Such an allocation of resources to one area of increasing spending will dramatically diminish the fund's sustainability in its current form, specifically as a payer of benefits such as Jobseekers Allowance, Illness Benefit and Carer's Benefit, as well as the various age-related benefits. Removing the link between PRSI contributions and pension entitlements and paying a universal pension from general taxation makes the SIF more sustainable into the future, as most of the remaining benefits paid from the fund are not related to age but to fluctuating economic factors and are not so demographically dependent.

Due to PRSI payments no longer being the basis by which people gain access to retirement benefits from the State, a downward adjustment of the PRSI rate to reflect this would be required. This is important, lest the use of PRSI to fund a universal benefit lead to PRSI being seen as a tax. This adjustment could be transferred to the USC, a broader charge which cannot be avoided through tax breaks.

Expenditure & Sustainability

This Study recognises that one long-term implication of increasing the State pension, especially considering the demographic trends already mentioned, will be increased direct Exchequer expenditure. Indeed, the *Green Paper on Pensions* makes reference at several points to the fact that many European countries have undertaken significant reforms in their pension systems in the last decade in response to growing crises in sustainability.

What it gives less prominence to is the fact that most of these systems are much more generous in terms of income to pensioners than the Irish State pension and that Ireland's demography is almost unique when it comes to its current high PSR (TASC/Trinity College PPRG, 2008, p.6). As well as this, projected economic growth in Ireland is higher than for many other European countries due to our

more favourable demographic outlook (Department of Social Protection, 2012b, p.5) and an old-age dependency rate well below the OECD average (Adema, 2010, p.29).

At the same time, the recent *Actuarial Review of the Social Insurance Fund* (Department of Social Protection, 2012, p.46) predicted a 'rapid and severe decline in the PSR from 5.3 in 2010 to 2.1 in 2050', while studies show that most people covered by the private system are likely to end up with inadequate savings for their retirement (OECD, 2013). With such an impending increase in Exchequer liability, this Study asserts that we can no longer afford to so heavily subsidise a private pension system that is failing to provide the coverage required for our elderly. Chapter 6 will show that USWP can be instituted in a sustainable fashion, at no additional expense to the Exchequer in the short-term, while better achieving the stated aims of the system.

Efficiency, Predictability & Flexibility

The USWP would have the added benefit of eliminating the cost of administering a means test and calculating social insurance contributions, while the future cost of this altered system is more easily predictable as the eligible population can be estimated using simple population projections and removing the small numbers excluded. The system would also give additional certainty to individuals planning for their retirements.

As noted, the proposal is not a radical overhaul of the system, but merely a tweak to better achieve the system's stated aims. Important also is that the system remains flexible, so that future governments may make the necessary changes that may be required further down the road. To quote Myles, 'we attach considerable importance to the principle that a main requirement of any new pension design is that it provides future generations with sufficient flexibility to adjust to the changing circumstances of both the old and the young' (Myles, 2002, p.137). The USWP does nothing to affect the long-term flexibility of the system.

Alternative Approaches

Many other possible changes were considered by this Study.

An Earnings-based State Pension

As discussed in Chapter 3, governments in some countries have attempted not just to provide an adequate standard of living for its retirees but to replace a certain level of the individual's pre-retirement income. One example of such an attempt is SERPS – now known as S2P, or the state second pension – in the UK, instituted under the Social Security Pensions Act of 1975. SERPS has since been deemed to 'impose excessive burdens on future generations' (Hill, 2005, p.158), hardly surprising given the aim of replacing a level of pre-retirement income for everyone, including high earners.

This Study does not see the responsibility of the State as being to maintain a living standard in retirement. As stated by a former Prime Minister of New Zealand, the country in the OECD which fares the best at relieving poverty among the elderly; 'Security in retirement is the least that citizens should expect from their government in a civilised developed country. It is also the most they should expect. It is not the function of the government to maintain in retirement the incomes that people earned during their working life. That is up to the individual' Cullen (2001). Many people want to fund for something higher than this. However when this responsibility is transferred to the public purse, it becomes a taxpayer expense and effectively an expense on those with lower incomes. This contravenes the ethos of this Study.

Increased Retirement Age

As stated earlier, the national retirement age is currently 65 years, but will have increased to 68 in 2028. One way to lower costs in the future is to increase the retirement age further, thereby reducing the amount of benefits paid over the life of each individual recipient. This Study discourages such a move. By definition and design, old age insurance – of which pensions are a primary form - is a mechanism that transfers income from those with shorter life expectancy to those with greater life expectancy (Myles, 2002, p.158). Therefore rising retirement ages disproportionately disadvantage people with shorter life expectancies, usually lower earners[39] who have less financial capacity to save for an earlier retirement. The result is an effective transfer of wealth from poor to rich for every one year increase in the retirement age, contravening the aim of greater equity in the system.

Increased Private Pension Coverage/Mandatory Enrolment

One way to plan for the additional expense an older population brings is to increase coverage rates in the private pensions system. However, it must be acknowledged that coverage targets and rates as currently measured prove little, as many of the pensions being provided may be inadequate yet statistics will show that the individual is covered by a private pension.

The *National Pensions Framework* (Department of Social and Family Affairs, 2010) proposed the introduction of a mandatory supplementary pension scheme for those without coverage through their jobs, along with a new universal rate of relief of 33% for pension contributions. This was never implemented and the current government has not displayed any intention to pursue it.

A report published earlier this year (OECD, 2013) noted that Ireland is one of only two countries in the OECD – New Zealand being the other – that does not have some form of mandatory supplementary provision to top up the State pension. There are a number of reasons not to change this. Firstly, such a reform would tie the pensions system as a whole more closely to the nexus of

[39] Low earnings have been consistently linked to health problems (LeGrand, Propper & Smith, 2008, p.77)

employment and earnings, and would therefore exacerbate rather than mitigate gender inequalities (National Women's Council of Ireland, 2008, p.3). Secondly, it would shift the focus still further onto the private pensions system, which has failed to achieve anything approaching either universality or adequacy of coverage, despite costly subsidies. Chapter 3 details the problems of inequality associated with the Australian superannuation system, while Adema (2010, p.41) has shown that 'gross public expenditures are effective in reducing poverty, while private social expenditures have the opposite effect'.

Conclusion

This Study proposes a reform of the Irish pension system which would significantly improve the extent to which it achieves its stated aims and the aims of many of its stakeholders. Having considered a number of other possibilities that would, to one extent or another, plan for the impending strain on the system, it has been established that our Five Point Plan is the most comprehensive and most likely to be effective given the objectives stated. It now remains to be shown that the USWP is not only effective, but financially viable in the long-term.

5. Methodology

Introduction

We have already discussed assumptions regarding poverty lines and minimum income standards. We have set ourselves the task of providing a designated weekly benefit of €263 to be paid to every long-term resident of the state who has reached the national retirement age. In order to project the cost of the USWP, this Study will utilise the population projections of the Central Statistics Office, based on Census 2011. These are contained in *Population and Labour Force Projections 2016-2046* (CSO, 2013b). The purpose of Chapter 5 is to provide a detailed explanation of the key assumptions relating to the data that will form the basis for the projections in Chapter 6.

Assumptions for Population Projections

The projections in *Population and Labour Force Projections 2016-2046* are based on assumptions relating to future trends in fertility, mortality and migration, used to project forward the 2011 population. The same report projects figures for the labour force participation rate. This is certainly relevant to the Study and the viability of the USWP. However while population projections are made to 2046, labour force projections are made only to 2026 and so cover less than half of the scope of this Study. However, these projections have still been incorporated into the assumptions used in this Study.

The CSO made numerous projections based on different sets of assumptions. The projections contained in this Study will be based on those deemed most relevant to the current situation. The process by which these projections were made is explained in detail in Appendix D. Let us analyse the different assumptions, and select the most relevant for the Study.

Fertility Rate

The CSO projections allowed for two different assumptions on fertility.

Table 5-1 shows the decline in the number of live births since 1960 for all age groups measured, bar the 15-19 year old group (and even that has been declining over the past decade). The decline in the TFR from its peak in 1965 to 1992 when it fell below the replacement rate for the first time is one factor that will make the Irish pension system unsustainable in its present form, as the population grows older and drives up age related expenditure.

Table 5-1 Age-specific Fertility Rate and Total Fertility Rate 1960 – 2011

	Live births per 1,000 females at specified ages							
Year	15-19	20-24	25-29	30-34	35-39	40-44	45-49	TFR
1960	8.8	103.9	209.6	213.1	156.3	56.0	4.2	3.76
1965	14.0	125.1	236.1	218.9	150.3	57.6	4.2	4.03
1970	16.3	145.5	228.7	201.9	131.9	45.3	3.7	3.87
1975	22.8	138.5	216.0	162.2	100.2	36.8	2.6	3.40
1980	23.0	125.3	202.3	165.7	97.3	29.6	2.3	3.23
1985	16.6	87.2	158.6	138.4	75.3	21.6	1.5	2.50
1990	16.7	63.3	137.6	126.2	63.1	15.4	1.1	2.12
1991	17.1	64.0	131.8	124.4	63.4	15.2	1.0	2.09
1992	16.9	58.9	123.9	122.3	61.3	14.4	0.8	1.99
1993	16.3	53.8	116.5	121.2	58.5	14.1	0.9	1.91
1994	15.0	50.7	112.5	119.8	58.6	12.8	0.7	1.85
1995	15.1	50.3	106.7	123.5	60.3	13.1	0.8	1.85
1996	16.7	52.2	105.3	127.1	63.9	11.8	0.6	1.99
1997	17.5	50.9	106.4	131.5	66.6	13.4	0.8	1.94
1998	19.2	52.5	103.1	131.5	69.3	13.4	0.6	1.95
1999	20.2	51.0	99.4	129.5	68.5	12.9	0.6	1.91
2000	19.5	51.6	95.1	129.3	71.3	13.6	0.5	1.90
2001	19.9	53.3	95.1	134.1	75.3	13.9	0.7	1.96
2002	19.4	52.8	93.7	134.5	80.0	14.5	0.6	1.98
2003	19.0	50.3	92.6	135.0	82.3	15.7	0.5	1.98
2004	17.1	49.1	88.4	134.2	83.9	16.2	0.5	1.95
2005	16.8	45.8	79.9	129.4	86.4	16.9	0.6	1.88
2006	16.4	49.5	82.1	130.4	90.8	18.1	0.8	1.94
2007	17.8	51.6	82.8	139.3	97.6	19.6	0.8	2.05
2008	17.2	55.2	86.3	140.1	100.6	19.9	1.2	2.10
2009	16.4	56.7	87.4	137.1	100.6	21.2	1.1	2.10
2010	15.3	57.0	89.0	136.2	99.5	22.0	1.1	2.10
2011	12.4	49.5	89.7	135.3	98.1	22.4	1.2	2.04

Figures from the CSO (2013b, p.9)

It was necessary for this Study to choose between two fertility assumptions; F1 and F2.

- **F1:** TFR to remain at the 2010 level of 2.1 for the lifetime of the projections
- **F2:** TFR to decrease to 1.8 by 2026 and to remain constant thereafter

This Study assumes a TFR as per F2, for the following reasons.

- The birth rates shown in Table 5-1 show a sharp decline from 1960 to 2005 across the main child-bearing age categories (ages 20-39). The recovery in recent years was to a significant extent due to an increase in the fertility rates of women in their thirties. This undoubtedly reflects a postponement effect whereby women are now giving birth later in life.

This is referred to in the CSO report as the 'tempo effect'. This Study considers it unlikely that this recovery will be maintained, and also agrees with the report's conclusion that further significant increases in the TFR are unlikely.

- The increased educational attainment and labour force participation of women are expected to exert downward pressure on fertility. There is some evidence to suggest an increase in birth rates due to the recession, with many women either now back in the home full-time or part-time. This Study assumes that this will not continue beyond economic recovery.

Mortality

The national trend in life expectancy in Ireland has been steadily upwards in the past century, with these trends expected to continue. Table 5-2 highlights these improvements.

Table 5-2 Gains in Life Expectancy at Various Ages 1926 – 2010

	Males			Females		
Period	**Birth**	**5 years**	**70 years**	**Birth**	**5 years**	**70 years**
1926-1946	3.1	2.0	-0.8	4.5	3.3	-0.5
1946-1961	7.6	4.2	0.5	9.5	6.5	0.8
1961-1971	0.7	-0.2	0.0	1.6	1.0	0.5
1971-1981	1.3	0.6	0.0	2.1	1.5	0.7
1981-1986	0.9	0.7	0.1	1.1	0.9	0.4
1986-1991	1.3	1.2	0.7	1.2	1.1	0.9
1991-1996	0.7	0.6	0.2	0.8	0.6	0.3
1996-2002	2.1	2.1	1.3	1.7	1.7	1.1
2002-2006	1.7	1.5	1.1	1.3	1.2	1.0
2007-2010	1.1	1.1	0.8	1.1	1.0	0.8
1926-2010	**20.5**	**13.8**	**3.9**	**24.9**	**18.9**	**6.0**

Figures from the CSO (2013b, p.13)

These significantly improved survival rates since the 1920s have been the result primarily of improvements in living conditions and medical treatment. More recently, the situation is still improving. Life expectancy at birth increased by 5.6 years for males in the last 20 years, and by 4.9 years over the same period for females. With a general consensus that these trends are set to continue, the CSO reached the following assumption regarding mortality:

Mortality rates are assumed to decrease which will result in gains in life expectancy at birth from:

- 77.9 years in 2010 to 85.1 years in 2046 for males
- 82.7 years in 2005 to 88.5 years in 2046 for females

The precise methodology used by the CSO for reaching these assumptions is described in more detail in Appendix E.

Migration

'While births and deaths are usually fairly predictable, the magnitude and indeed the direction of migration are more difficult to forecast' (Punch, 2005, p.2). The CSO (2013b, p.16) admits that migration has been the dominant influence on the profile of population change in Ireland. It is also the most volatile factor, and the extent to which it drives population change can be seen clearly in Figure 5-1.

Figure 5-1 Components of Population Change

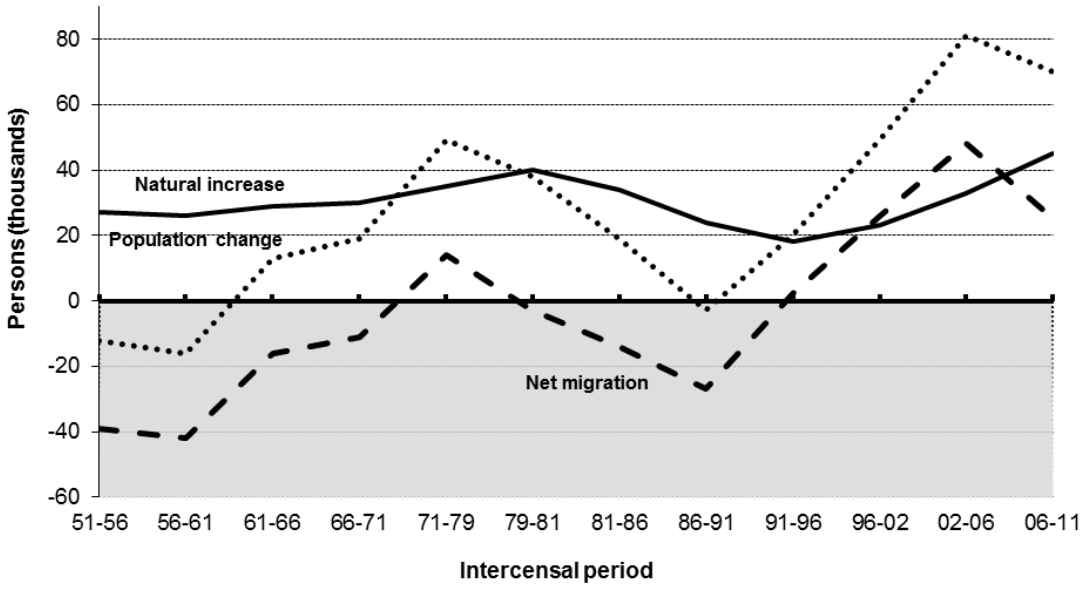


Chart from the CSO (2013b)

A more illustrative indicator of actual migration figures in Ireland can be seen in Tables 5-4 and 5-5. These show estimated net migration at different intervals from 1926 to 2011 and estimated yearly figures for emigration and immigration from 1997 to 2012.

Table 5-3 Estimated Net Migration 1926 – 2011

Period	Estimated net migration (thousands)
1926 - 1936	-17
1936 - 1946	-19
1946 - 1951	-24
1951 - 1956	-39
1956 - 1961	-42
1961 - 1966	-16
1966 - 1971	-11
1971 - 1979	14
1979 - 1981	-3
1981 - 1986	-14
1986 - 1991	-27
1991 - 1996	2
1996 - 2002	26
2002 - 2006	48
2006 - 2011	25

Figures from the CSO (2013b, p.7)

Table 5-4 Estimated Migration 1997 – 2012

Year ending April	Emigrants (thousands)	Immigrants (thousands)	**Net Migration (thousands)**
1997	25.3	44.5	**19.2**
1998	28.6	46.0	**17.4**
1999	31.5	48.9	**17.3**
2000	26.6	52.6	**26.0**
2001	26.2	59.0	**32.8**
2002	25.6	66.9	**41.3**
2003	29.3	60.0	**30.7**
2004	26.5	58.5	**32.0**
2005	29.4	84.6	**55.1**
2006	36.0	107.8	**71.8**
2007	46.3	151.1	**104.8**
2008	49.2	113.5	**64.3**
2009	72.0	73.7	**1.6**
2010	69.2	41.8	**-27.5**
2011	80.6	53.3	**-27.4**
2012	87.1	52.7	**-34.4**

Figures from the CSO (2013b, p.16)

The assumptions on which the CSO's projections were based are:

M1: Net migration returning to positive by 2016 and rising steadily thereafter
- -19,100 annual average per annum in 2011/2016
- +18,200 annual average per annum in 2016/2021
- +30,000 per annum in 2021/2026
- +30,000 per annum in 2026/2046

M2: Net migration returning to positive by 2018 and rising thereafter
- -21,600 annual average per annum in 2011/2016
- +4,700 annual average per annum in 2016/2021
- +10,000 per annum in 2021/2026
- +10,000 per annum in 2026/2046

M3: Net migration remaining negative for the whole period.
- -25,100 annual average per annum in 2011/2016
- -10,000 annual average per annum in 2016/2021
- -5,000 per annum in 2021/2026
- -5,000 per annum in 2026/2046

This Study has chosen **M2** as the most appropriate assumption for Migration. M1's projections to 2016 seem unrealistic, given current economic circumstance and the 2012 net migration figure of approximately -34,000. Meanwhile, M3 appears too negative in that it assumes that net migration will be negative right the way through to 2046.

Summary of Assumptions

The population projections used by this Study assume:

- The TFR will decrease to 1.8 by 2026 and remain constant thereafter.
- A continuation of the trend of improvement in mortality rates, with life expectancy in 2046 expected to be 85.1 years for males, and 88.5 years for females.
- Net migration of an annual average of -21,600 until 2016, before returning to positive growth of 4,700 per annum until 2021, and finally settling at 10,000 per annum for the remainder of the period.

Conclusion

As is shown in this Chapter, and in the relevant appendices, the population projections on which this research is based is sound, appropriate, and well-sourced. The assumptions made regarding different aspects of population growth too are justifiable. We now proceed to Chapter 6, where the viability of the USWP will be illustrated.

6. Data & Cost Projections

Introduction

The primary aim of this chapter is to calculate the number of people that would be entitled to the USWP and to project the cost of implementing the USWP to 2046. Chapter 6 will also compare this to the cost of maintaining the current system and demonstrate how the difference could be funded.

Establishing these projections has been hindered by several factors and so the author has made calculations based on the best data available. Examples of such factors include the unavailability of;

1. Up to date figures for the number of public service pensioners; information about whether or not those pensioners are pre-April 6th 1995 recruits; and their age and gender profiles.
2. An age and gender profile for the pre-April 6th 1995 public servants still in employment.
3. Data regarding the levels of pensions being paid to pre-April 6th 1995 public servants, and the extent to which such individuals have accumulated entitlements based on PRSI payments under other PRSI classes.
4. A detailed break-down of the age profile of recipients of the Widow's pension, and of State pension recipients living abroad.

These challenges have led to inconsistencies between this Study's calculations and figures used by the Department of Social Protection. However, every effort has been made to ensure that the assumptions used to compensate for the lack of comprehensive data have been reasonable and justifiable.

Box 6-1 Summary of Assumptions used in this Chapter

The projections used in this Chapter assume:

- The TFR will decrease to 1.8 by 2026 and remain constant thereafter.
- A continuation of the trend of improvement in mortality rates, with life expectancy in 2046 expected to be 85.1 years for males and 88.5 years for females.
- Net migration of an annual average of -21,600 until 2016, before returning to positive growth of 4,700 per annum until 2021 and finally settling at 10,000 per annum for the remainder of the period.
- Inflation at 2% per annum[40] for the duration of the projections.
- Earnings growth at 2.5% per annum[41] for the duration of the projections.
- Current value terms are calculated using a discount rate of 4% per annum[42].
- Nominal GDP growth of 4.5%, year-on-year, from 2015 onwards.

State Pension Expenditure by Type

Table 6-1 shows the cost in 2012 of each type of social welfare pension, and the number of recipients of each pension type.

Table 6-1 Expenditure and Number of Recipients by Pension Type in 2012

Pension Type	Expenditure	Number of recipients
State pension (non-contributory)	€963m	96,126
State pension (contributory)	€3,800m	312,314
State pension (Transition)	€146m	14,372
Sub-Total	**€4,909m**	**422,812**
Widow's pension	€1,342m	116,751
Total	**€6,251m**	**539,563**

Figures from Department of Social Protection (2013, p.28)

Table 6-2 shows the number of recipients of the Widow's pension by age. As all residents over the age of 66 would be in receipt of the USWP, the Widow's pension would no longer be paid to these individuals. Approximately €1.036 billion[43] in Widow's pension payments were made to individuals over age 65 in 2012.

[40] The primary objective of the ECB's monetary policy is to maintain price stability. The ECB aims at inflation rates of below, but close to, 2% over the medium term (ECB, 2013).
[41] The assumption is that earnings growth will track inflation, plus a little extra.
[42] This figure is in line with the social discount rate used by the Department of Finance (Central Expenditure Evaluation Unit, 2012, p.6).
[43] This is the author's own calculation. The numbers of recipients of the Widow's pension aged exactly 65 – and therefore receiving the benefit at the lower rate – was calculated based on total expenditure on the benefit, the rates of the benefit for different age groups, and the numbers in each age category according to the Department of Social Protection (2013, p.30).

Table 6-2 Recipients of the Widow's Pension in 2012 by age category

Age group	Recipients
<65 years old	30,369
65-80 years old	50,360
80+ years	36,022
Total	**116,751**

Figures from Department of Social Protection (2013, p.30)

Based on the above, Table 6-3 illustrates the cost in 2012 of each type of pension – and the number of recipients of each type – to people aged 65 and over *only*.

Table 6-3 Pension Benefits Paid to over 65s by Payment Type in 2012

Pension Type	Expenditure	Number of recipients
State pension (non-contributory)	€963m	96,126
State pension (contributory)	€3,800m	312,314
State pension (Transition)	€146m	14,372
Widow's pension (65 and older)	€1,036m	86,382
Total	**€5,945m**	**509,194**

Eligibility for the Universal Social Welfare Pension

Individuals above the National Retirement Age

Table 6-4 shows the projected numbers of people who will have reached the national retirement age (NRA) in each year from 2014 to 2046. This was calculated using the CSO's *Population and Labour Force Projections 2016-2046*, incorporating the aforementioned population change assumptions and taking into account the legislated increases in the NRA. The table highlights the challenge facing Ireland, as the number of pensioners is set to more than double by 2046.

Table 6-4 Residents above the National Retirement Age to 2046

Year	People above NRA	As a % of the overall population
2014	543,446	11.75%
2015	562,104	12.08%
2016	581,050	12.40%
2017	600,249	12.71%
2018	619,892	13.02%
2019	641,389	13.37%
2020	662,184	13.69%
2021	637,472	13.08%
2022	659,204	13.42%
2023	680,601	13.76%
2024	702,915	14.11%
2025	725,656	14.48%
2026	748,292	14.84%
2027	772,233	15.23%
2028	743,934	14.59%
2029	768,660	14.99%
2030	792,383	15.36%
2031	816,894	15.75%
2032	842,108	16.14%
2033	868,200	16.55%
2034	893,125	16.93%
2035	917,635	17.29%
2036	942,103	17.65%
2037	966,147	18.00%
2038	992,632	18.39%
2039	1,019,746	18.78%
2040	1,046,295	19.16%
2041	1,073,361	19.55%
2042	1,099,319	19.91%
2043	1,125,448	20.28%
2044	1,150,688	20.62%
2045	1,175,320	20.96%
2046	1,199,840	21.29%

Estimating Pre-April 6th 1995 Public Servants

As mentioned in Chapter 4, pre-April 6th 1995 public servants will not receive the USWP because of their own occupational pension entitlements from the State and the consequent reduced rate of PRSI. Their numbers were estimated using statistics on PRSI class. Pre-April 6th 1995 public servants pay PRSI under classes B, C and D. The most recent figures available (see Table 6-5) show that in 2011[44], there were 88,834 pre-April 6th 1995 public servants still working in the service.

Table 6-5 Pre-April 6th 1995 public servants in 2011 by PRSI class and Gender

PRSI Class	Male	Female	Total
B	12,989	10,870	23,859
C	567	51	618
D	26,656	37,701	64,357
Total	40,212	48,622	**88,834**

Figures from the Department of Social Protection (2013, Table A15)

Without information on the age-profile of these individuals, these public servants were distributed across each age group from 33 to 64, therefore assuming that none were recruited before their 17th birthday. In order that relevant mortality rates were applied, they were distributed in proportion to the gender-specific share of the population of each age group in 2011.

There were also 123,954 public sector pensioners in 2009[45] (Comptroller and Auditor General, 2010, p.30). An assumption that 90% of these were pre-April 6th 1995 recruits[46] gives us a figure of 111,558. An even gender split has been assumed, and as illustrated above they were proportioned across each age group according to their gender-specific share of the population in 2011. Year-specific mortality rates were then applied to each cohort to 2046.

[44] These figures are provisional.
[45] This is the most recently available figure.
[46] While early retirement is a possibility, it was assumed that for these individuals to be in receipt of a pension in 2009 and be a *post*-April 6th 1995 recruit, they would have been recruited after their 51st birthday. We therefore believe this estimate to be a conservative one and that in fact more would be excluded from the USWP, reducing the cost further. It is also acknowledged that using a figure from 2009 is far from ideal, given the high number of early retirements that have taken place in the public service since then. However, we expect the vast majority of these retirees are also pre-April 6th 1995 recruits, not entitled to the USWP, and many will have been accounted for in Table 6-5 anyway.

Pensioners Living Abroad

Department of Social Protection figures indicate that there are 54,172 recipients of the State pension living outside Ireland (see Table 6-6).

Table 6-6 State Pension Recipients living abroad in 2012 by Pension Type

Pension Type	Number of recipients
State pension (non-contributory)	27
State pension (contributory)	44,278
State pension (Transition)	1,826
Widow's pension	8,041
Total	**54,172**
Estimated number aged 65 and over	**52,081**[47]

Department of Social Protection (2013, Table B8)

By applying the same ratio to Widow's pension recipients living abroad as was applied to the resident population of Widow's pensioners, we can estimate that 52,081 recipients of these benefits are aged over 65. These individuals have acquired these benefits under the current system, and will not be deprived of them. They will be added to our figure for recipients of the USWP and proportioned across the population using the same gender and age assumptions applied to pre-April 6th 1995 public servants.

[47] Author's calculation.

Estimation of Individuals Eligible for the USWP

Table 6-7 shows the number of individuals eligible for the USWP following the removal of ineligible pre-April 6th 1995 public servants, and accounting for social welfare pension recipients currently living abroad.

Table 6-7 Individuals Eligible for the USWP to 2046

Year	Recipients of the USWP	As a % of the overall population
2014	490,259	10.60%
2015	509,502	10.95%
2016	528,987	11.29%
2017	548,683	11.62%
2018	568,773	11.95%
2019	590,606	12.31%
2020	611,743	12.65%
2021	589,496	12.09%
2022	611,469	12.45%
2023	633,093	12.80%
2024	655,560	13.16%
2025	678,396	13.54%
2026	701,096	13.90%
2027	724,998	14.30%
2028	699,089	13.71%
2029	723,648	14.11%
2030	747,201	14.49%
2031	771,453	14.87%
2032	796,317	15.26%
2033	821,962	15.67%
2034	846,439	16.04%
2035	870,465	16.40%
2036	894,395	16.76%
2037	917,865	17.10%
2038	943,601	17.48%
2039	969,874	17.86%
2040	995,539	18.23%
2041	1,021,629	18.61%
2042	1,046,597	18.96%
2043	1,071,667	19.31%
2044	1,095,834	19.64%
2045	1,119,375	19.96%
2046	1,142,742	20.28%

Projected Expenditure under the USWP

Calculating Expenditure under the Current System

The next step is to compare projected expenditure under the current system to that under the proposed USWP.

Figures projecting the amount to be spent on the State pension under the current system are not available from the Department of Finance. Therefore, the author has projected forward the cost of the State pension in 2012 to individuals over aged 65 using the following assumptions;

- Benefit levels would begin to increase again in 2015[48] at a rate equal to the rate of inflation.
- The number of recipients would increase each year at the same rate as the general population reaches the NRA, plus 0.2%. This is to take account of the aforementioned projected increase in coverage by the social welfare pension from 88% of the population in 2006 to 98% by 2056 (Department of Social and Family Affairs, 2007, p.69).

Implementation of the USWP

It hardly requires stating that Ireland's current fiscal situation is not a particularly robust one. To allow the public finances additional time for recovery, it is proposed to phase in the increase to the State pension over a five year period. Assuming the Minimum Income Standard increases at the rate of inflation until 2018, the USWP payment will increase gradually to €14,803 per annum in 2018 and will increase at the rate of inflation thereafter.

Table 6-8 shows the amount of projected expenditure under the USWP, compared to the amount of projected expenditure if the current system is maintained, based on the assumptions detailed in this and previous chapters.

[48] This acknowledges that there is no plan to increase the amount of the State pension in the upcoming Budget.

Table 6-8 Projected Expenditure under each System

Year	Expenditure under current system	In current terms	Annual Pension (USWP)	Weekly pension (USWP)	Expenditure under proposed system	In current terms
2014	€5,908,312,306	€5,681,069,525	€12,529	€241	€6,142,288,078	€5,906,046,229
2015	€6,245,850,950	€5,774,640,301	€13,097	€252	€6,673,124,765	€6,169,678,962
2016	€6,598,668,926	€5,866,192,647	€13,666	€263	€7,229,139,690	€6,426,678,860
2017	€6,966,941,632	€5,955,370,905	€14,235	€274	€7,810,324,035	€6,676,297,718
2018	€7,353,509,398	€6,044,048,704	€14,803	€285	€8,419,746,976	€6,920,418,272
2019	€7,776,210,724	€6,145,652,291	€15,099	€290	€8,917,801,676	€7,047,868,202
2020	€8,205,274,030	€6,235,333,897	€15,401	€296	€9,421,699,130	€7,159,717,000
2021	€8,073,157,288	€5,898,976,954	€15,709	€302	€9,260,645,155	€6,766,662,707
2022	€8,532,376,822	€5,994,734,778	€16,024	€308	€9,797,940,634	€6,883,903,126
2023	€9,003,485,500	€6,082,432,199	€16,344	€314	€10,347,325,972	€6,990,282,670
2024	€9,503,614,053	€6,173,366,470	€16,671	€321	€10,928,813,464	€7,099,148,831
2025	€10,027,315,129	€6,263,031,445	€17,004	€327	€11,535,713,301	€7,205,172,493
2026	€10,568,001,560	€6,346,867,879	€17,344	€334	€12,160,137,625	€7,303,063,541
2027	€11,146,487,063	€6,436,818,540	€17,691	€340	€12,826,209,453	€7,406,816,366
2028	€10,974,682,398	€6,093,851,564	€18,045	€347	€12,615,199,431	€7,004,772,438
2029	€11,589,367,323	€6,187,657,965	€18,406	€354	€13,319,540,092	€7,111,411,351
2030	€12,210,360,581	€6,268,472,445	€18,774	€361	€14,028,121,349	€7,201,662,190
2031	€12,865,508,000	€6,350,776,540	€19,150	€368	€14,773,088,134	€7,292,411,737
2032	€13,554,918,773	€6,433,739,504	€19,533	€376	€15,554,219,473	€7,382,692,435
2033	€14,282,913,337	€6,518,535,201	€19,923	€383	€16,376,236,480	€7,473,900,557
2034	€15,016,791,781	€6,589,872,829	€20,322	€391	€17,201,185,085	€7,548,458,011
2035	€15,768,949,996	€6,653,793,393	€20,728	€399	€18,043,228,248	€7,613,437,352
2036	€16,546,231,115	€6,713,241,681	€21,143	€407	€18,910,024,367	€7,672,294,850
2037	€17,342,503,963	€6,765,683,215	€21,566	€415	€19,794,370,956	€7,722,209,181
2038	€18,210,621,075	€6,831,109,945	€21,997	€423	€20,756,386,215	€7,786,069,223
2039	€19,120,374,301	€6,896,513,140	€22,437	€431	€21,760,984,041	€7,848,952,642
2040	€20,050,556,114	€6,953,865,101	€22,886	€440	€22,783,575,093	€7,901,721,369
2041	€21,022,578,231	€7,010,556,228	€23,343	€449	€23,848,265,655	€7,952,859,325
2042	€22,005,527,993	€7,056,103,682	€23,810	€458	€24,919,726,305	€7,990,545,493
2043	€23,025,092,640	€7,099,065,893	€24,286	€467	€26,026,983,176	€8,024,604,784
2044	€24,060,321,702	€7,132,929,171	€24,772	€476	€27,146,208,983	€8,047,772,110
2045	€25,117,005,780	€7,159,801,928	€25,268	€486	€28,283,958,548	€8,062,566,961
2046	€26,206,134,679	€7,182,948,816	€25,773	€496	€29,451,853,635	€8,072,581,470

The Cost of Pension Tax Reliefs

The ESRI (2009, p.28) estimated that in 2005, the standardisation of tax relief on all contributions would have raised €1.102 billion. This was calculated on a revenue foregone basis and did not allow for behavioural changes. However, it is likely that the same alteration in 2014 would raise a much lower figure, given the changed economic circumstances and alterations to the tax regime in the years since.

The *National Recovery Plan* (Department of Finance, 2010, pp.93-94) estimated that this measure would now save about €500m in a full year, while the consequential reduced rate of relief on the public service "pension-related deduction" would yield a further €240 million in a full year.

In response to a parliamentary question on October 25th 2012, the Minister for Finance estimated that reducing the current annual earnings cap of €115,000 to €75,000[49] would raise about €113 million (Ireland, Dáil 2012). It is assumed that reducing it to €80,000 would yield approximately €100 million.

Table 6-9 Money Raised by Proposed Alteration to Tax Reliefs

Alteration	Amount
Standardisation of relief at 20% in private sector	€500m
Reduced rate of relief on public service pension deductions	€240m
Reducing the earnings cap to €80,000	€100m
Total	**€840m**

If left unaltered for the duration of these projections, the cost of the current system of tax reliefs could be expected to fluctuate with earnings rates and labour market conditions. Earnings are projected to increase at 2.5% per annum, as previously noted. The projections for growth in pension-related tax expenditure on the following pages also take into account the CSO's (2013b, Table 9) projections for average labour force growth over the period[50].

Based on these assumptions, Table 6-10 illustrates the projected net effect on expenditure to 2046, while Table 6-11 illustrates the same in current terms.

[49] This includes contributions to occupational pension schemes, RACs and PRSAs. It also includes the effect of a similar limitation to tax reliefs for the public service pension.

[50] This is calculated at -0.3% per annum from 2011-2016, +0.74% per annum from 2017-2021, and +0.78% per annum from 2021-2026. The projection also assumes that this growth in the labour force will continue from 2026 to 2032. Though the CSO only publishes labour force projections to 2026, population growth among people of working age would suggest this trend is likely to continue to 2032. Average increases from 2033 to 2046 are more difficult to predict; based on overall population projections these are likely to be negligible. Unemployment rates have not been accounted for. Given that employment rates are likely to improve over the duration of the projections, we deem the amounts projected to be saved from this change to the tax relief system to be conservative. The proposed changes would likely generate more savings over the long-term.

Table 6-10 Expenditure Comparisons – Nominal terms, 2014-2046

Year	Projected Expenditure under current system	Projected Expenditure under the USWP	Projected savings in tax reliefs	Net effect on expenditure under the USWP
2014	€5,908,312,306	€6,142,288,078	€840,000,000	-€606,024,228
2015	€6,245,850,950	€6,673,124,765	€860,741,700	-€433,467,885
2016	€6,598,668,926	€7,229,139,690	€881,995,564	-€251,524,801
2017	€6,966,941,632	€7,810,324,035	€910,735,390	-€67,352,987
2018	€7,353,509,398	€8,419,746,976	€940,411,703	€125,825,876
2019	€7,776,210,724	€8,917,801,676	€971,055,018	€170,535,934
2020	€8,205,274,030	€9,421,699,130	€1,002,696,846	€213,728,255
2021	€8,073,157,288	€9,260,645,155	€1,035,369,722	€152,118,145
2022	€8,532,376,822	€9,797,940,634	€1,069,531,746	€196,032,066
2023	€9,003,485,500	€10,347,325,972	€1,104,820,946	€239,019,526
2024	€9,503,614,053	€10,928,813,464	€1,141,274,513	€283,924,898
2025	€10,027,315,129	€11,535,713,301	€1,178,930,866	€329,467,306
2026	€10,568,001,560	€12,160,137,625	€1,217,829,690	€374,306,375
2027	€11,146,487,063	€12,826,209,453	€1,258,011,981	€421,710,410
2028	€10,974,682,398	€12,615,199,431	€1,299,520,086	€340,996,947
2029	€11,589,367,323	€13,319,540,092	€1,342,397,751	€387,775,018
2030	€12,210,360,581	€14,028,121,349	€1,386,690,165	€431,070,603
2031	€12,865,508,000	€14,773,088,134	€1,432,444,007	€475,136,127
2032	€13,554,918,773	€15,554,219,473	€1,479,707,497	€519,593,203
2033	€14,282,913,337	€16,376,236,480	€1,516,700,184	€576,622,959
2034	€15,016,791,781	€17,201,185,085	€1,554,617,689	€629,775,615
2035	€15,768,949,996	€18,043,228,248	€1,593,483,131	€680,795,121
2036	€16,546,231,115	€18,910,024,367	€1,633,320,209	€730,473,043
2037	€17,342,503,963	€19,794,370,956	€1,674,153,215	€777,713,779
2038	€18,210,621,075	€20,756,386,215	€1,716,007,045	€829,758,095
2039	€19,120,374,301	€21,760,984,041	€1,758,907,221	€881,702,519
2040	€20,050,556,114	€22,783,575,093	€1,802,879,902	€930,139,077
2041	€21,022,578,231	€23,848,265,655	€1,847,951,899	€977,735,525
2042	€22,005,527,993	€24,919,726,305	€1,894,150,697	€1,020,047,615
2043	€23,025,092,640	€26,026,983,176	€1,941,504,464	€1,060,386,072
2044	€24,060,321,702	€27,146,208,983	€1,990,042,076	€1,095,845,205
2045	€25,117,005,780	€28,283,958,548	€2,039,793,128	€1,127,159,640
2046	€26,206,134,679	€29,451,853,635	€2,090,787,956	€1,154,931,000

Table 6-11 Expenditure Comparisons – Current terms, 2014-2046

Year	Projected Expenditure under current system	Projected Expenditure under the USWP	Projected savings in tax reliefs	Net effect on expenditure under the USWP
2014	€5,681,069,525	€5,906,046,229	€807,692,308	-€582,715,603
2015	€5,774,640,301	€6,169,678,962	€795,804,087	-€400,765,426
2016	€5,866,192,647	€6,426,678,860	€784,090,845	-€223,604,632
2017	€5,955,370,905	€6,676,297,718	€778,500,428	-€57,573,615
2018	€6,044,048,704	€6,920,418,272	€772,949,870	€103,419,698
2019	€6,145,652,291	€7,047,868,202	€767,438,886	€134,777,026
2020	€6,235,333,897	€7,159,717,000	€761,967,194	€162,415,908
2021	€5,898,976,954	€6,766,662,707	€756,534,515	€111,151,239
2022	€5,994,734,778	€6,883,903,126	€751,438,818	€137,729,529
2023	€6,082,432,199	€6,990,282,670	€746,377,444	€161,473,027
2024	€6,173,366,470	€7,099,148,831	€741,350,162	€184,432,200
2025	€6,263,031,445	€7,205,172,493	€736,356,741	€205,784,307
2026	€6,346,867,879	€7,303,063,541	€731,396,953	€224,798,709
2027	€6,436,818,540	€7,406,816,366	€726,470,573	€243,527,254
2028	€6,093,851,564	€7,004,772,438	€721,577,374	€189,343,500
2029	€6,187,657,965	€7,111,411,351	€716,717,134	€207,036,252
2030	€6,268,472,445	€7,201,662,190	€711,889,631	€221,300,115
2031	€6,350,776,540	€7,292,411,737	€707,094,644	€234,540,554
2032	€6,433,739,504	€7,382,692,435	€702,331,953	€246,620,978
2033	€6,518,535,201	€7,473,900,557	€692,202,165	€263,163,191
2034	€6,589,872,829	€7,548,458,011	€682,218,480	€276,366,701
2035	€6,653,793,393	€7,613,437,352	€672,378,791	€287,265,168
2036	€6,713,241,681	€7,672,294,850	€662,681,020	€296,372,149
2037	€6,765,683,215	€7,722,209,181	€653,123,120	€303,402,846
2038	€6,831,109,945	€7,786,069,223	€643,703,075	€311,256,203
2039	€6,896,513,140	€7,848,952,642	€634,418,896	€318,020,605
2040	€6,953,865,101	€7,901,721,369	€625,268,624	€322,587,644
2041	€7,010,556,228	€7,952,859,325	€616,250,326	€326,052,770
2042	€7,056,103,682	€7,990,545,493	€607,362,101	€327,079,711
2043	€7,099,065,893	€8,024,604,784	€598,602,070	€326,936,821
2044	€7,132,929,171	€8,047,772,110	€589,968,387	€324,874,552
2045	€7,159,801,928	€8,062,566,961	€581,459,227	€321,305,805
2046	€7,182,948,816	€8,072,581,470	€573,072,796	€316,559,858

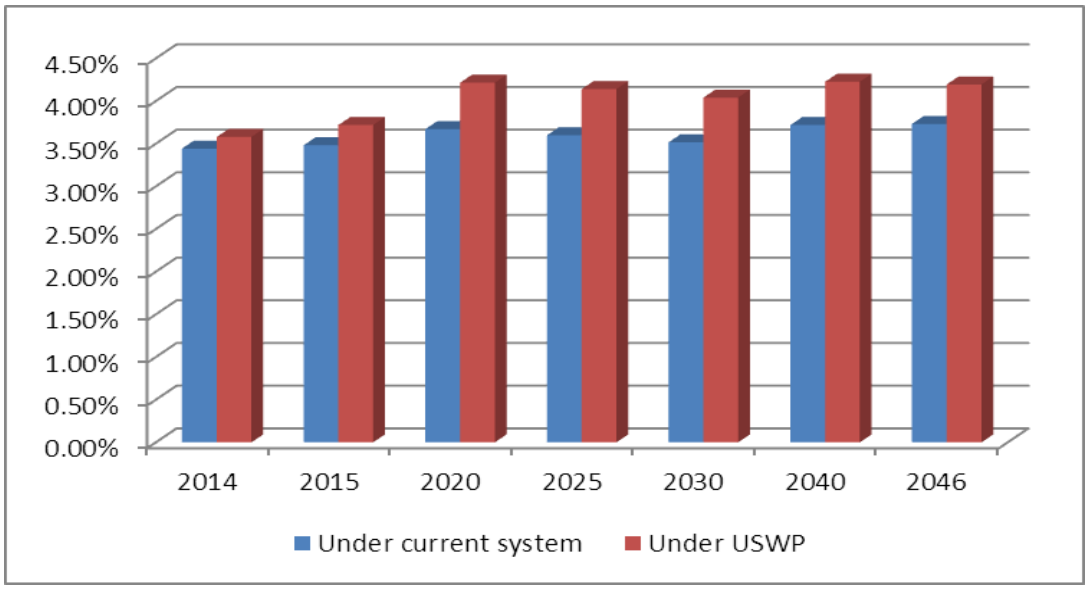
Expenditure compared to GDP

This Study felt it prudent to include expenditure to GDP ratios. The Department of Finance's (2012, p.9) *Economic and Fiscal Outlook* predicts GDP for 2014 at €171.62 billion – a nominal growth rate of 4.3% – with nominal growth at just over 4.5% year-on-year in 2015. The projections in Table 6-12 assume that such average growth rates will continue to 2046. Figure 6-1 displays projected expenditure under each system as a percentage of projected GDP.

Table 6-12 GDP Projections to 2046

	2014	**2015**	**2020**	**2025**	**2030**	**2040**	**2046**
			GDP Projections				
Increase in GDP	3.0%	3.0%	2.5%	2.5%	2.5%	2.5%	2.5%
GDP amount (€, billion)	171.62	179.42	223.59	278.64	347.23	539.25	702.24
Inflation (p.a.)	1.3%	1.5%	2.0%	2.0%	2.0%	2.0%	2.0%
Nominal GDP growth (y/y)	4.3%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
			Expenditure projections as a % of GDP				
Under current system	3.44%	3.48%	3.67%	3.60%	3.52%	3.72%	3.73%
Under USWP	3.58%	3.72%	4.21%	4.14%	4.04%	4.23%	4.19%

Figure 6-1 Expenditure as a % of GDP to 2046



Conclusion

This chapter estimates the number of people that would be eligible for the USWP, and the cost of implementing the USWP to 2046 compared to maintaining the current system. This has been done using projected numbers of people above the NRA, and subtracting the estimated number of individuals who would be excluded while including those living abroad with a social welfare pension entitlement. The additional cost of this benefit was then estimated, net of the potential savings from a change to the current regime of tax relief.

The projections shown in this chapter indicate that it is possible, for little additional cost, to develop a national pension system

- That is financially equitable, not serving to most benefit the richest in society
- That does not discriminate according to gender or work-type
- That gives certainty to individuals planning for retirement
- That encourages people to save for their retirement in a tax-efficient manner while reducing the direct cost of this to the Exchequer
- That alleviates and indeed eliminates poverty in old-age; the very thing national pension systems were designed to do

Finally, it shows that it is possible to do all this in a manner that is affordable and sustainable. While some additional funding is required in the long-term, the annual net effect until 2018 is a reduction in expenditure for the Exchequer, while the aggregate change in expenditure remains negative until 2024 – or until 2026 if measured in current terms.

7. Analysis & Implications

Introduction

Following the projections and data analysis in Chapter 6, this chapter will discuss and analyse the implications of the proposal. Many of the implications of the USWP have already been discussed under the *Aims of the Proposal* in Chapter 4. To summarise these, the proposal will;

- Make the system more financially equitable. Lowering the rate of tax relief reduces the extent to which those on lower incomes subsidise the retirements of the better-off.
- Virtually eliminate poverty among the elderly while protecting the real-value of their living standards over time.
- End discrimination in the pension system.
- Bring universal coverage to the elderly.
- Increase administrative efficiency and predictability for the State.
- Increase certainty for individuals planning for their retirement.

In this Chapter, we will discuss the financial ramifications of the proposal and the impact on society at large.

Financial Implications

As noted at the end of Chapter 6, the proposal made by this Study is both affordable and sustainable. While some additional funding is required in the long-term, the immediate effect on the public finances is a positive one, and in the medium-term the proposal would result in an aggregate surplus of funds until 2024 – or until 2026 if measured in current terms. The net additional expenditure in current terms from 2014 to 2046 would be approximately €5.825 billion, given the assumptions used.

Table 6-11 notes that the ambitious aims of the proposal can be achieved with a maximum additional spend of little more than €300 million per annum in current terms, or 3.8% of the total amount currently been spent by the State on the pension system[51]. No additional expenditure will be required for several years, so the proposal does not put any immediate pressure on the public finances while giving sufficient time for the economy to recover before the additional funds are required.

In this regard it should be noted that there is still plenty of room for sourcing such funding from within the system. Long after the changes suggested by this Study might be implemented, there would be well in excess of €1.5 billion still being foregone each year on pension-related tax reliefs. There are a number of

[51] Assumed to amount to €8,424 million, as per Table 4-1.

ways in which this could be reduced that have not been tackled by this Study, primarily due to space constraints. One suggestion is a further alteration to the SFT, which could potentially raise several hundred million euros[52]. Another possible source is the almost €1 billion[53] foregone annually in tax on investment gains for pension funds.

One thing is clear; there is more than enough money already in the pension system to achieve the goals set by both the government and by this Study. What is needed is the political will to make the necessary changes.

Tax Expenditures – A Cost-Benefit Analysis

Governments collect taxes for two broad reasons; first, it provides revenue to run the state and pay for the provision of public services, infrastructure and the funding of redistributive policies. Second, taxation is used to alter behaviour; to discourage certain activities and encourage others (Collins, 2011, p.1).

In general, assessment of the costs and socioeconomic implications of tax expenditures have been less than adequate. One reason for this is that the exchequer costs of such measures have essentially been invisible in that they are 'revenue forgone'. Furthermore, comprehensive data is often not collected to allow an assessment of the nature, distribution and scale of the tax expenditure (Collins & Walsh, 2011, p.19).

Rapple (2004, pp.76-77) too admits that the balance between the costs and benefits of tax expenditures is not easy to assess. There is a need to consider:

- How much of the encouraged activity would have taken place without the initiative? In other words how much of the tax relief is going to people who would do what you want them to do without any incentive?
- Is the encouraged activity actually good for society and the economy?
- Does the encouraged activity have a negative impact on other areas of the economy?
- Will the tax relief result in unacceptable inequities in the share out of the tax burden? This may be subjective but perceived inequities can have as adverse an effect on economic and social behaviour as real inequities

Let us examine the findings of this Study from the point of view of Rapple's criteria.

Deadweight Loss

As mentioned in Chapter 2, the ESRI (2009, p.vii) has noted that UK and US studies indicate significant deadweight loss associated with tax incentives for pensions. While acknowledging that no consensus has yet been reached, it states that 'some recent studies of Individual Retirement Accounts in the US, and Tax

[52] As noted in the *National Recovery Plan 2011-2014* (Department of Finance, 2010, p.94).
[53] See Appendix C.

Exempt Special Savings Accounts and Individual Savings Accounts in the UK conclude that only small fractions of the amounts saved in these schemes represented new savings. The corollary is that these policies have been an expensive means of encouraging saving, with large deadweight losses associated with the reshuffling of existing savings.'

The report also concludes that households who normally save the most were largely contributing funds that they would have saved anyway. Taken together, these results suggest that tax incentives do face a substantial "deadweight" problem in that they are subsidising savings that would take place anyway, and that this is particularly so for those on higher incomes. Though private pension arrangements can be assumed to have *some* positive impact on national savings, it comes at considerable expense to the Exchequer.

Benefit to Society & Economic Impact

The *National Pensions Framework* (Department of Social and Family Affairs, 2010, p.4) notes that fostering a successful supplementary pension environment assists in creating financial stability and wealth, while it is a reasonable assumption that such activity has some positive impact on national savings. There are also some economic benefits in the form the jobs created; pension scheme administration, pension fund investment, industry regulation etc. are large and profitable enterprises and many people depend on the industry for employment. However, as stated at the beginning of this Study; pensions do not exist to provide jobs for actuaries, tax lawyers, accountants, fund managers and regulators, and such things should not be a primary consideration in developing pension policy.

There is an economic opportunity cost in foregoing in excess of €2 billion every year; money that could be spent on things such as improved public services, investment in much needed capital projects, job creation schemes and indeed poverty relief; the very thing which the system was originally designed to achieve.

Conversely, there would be an economic benefit to Ireland under the implementation of the USWP. By making a progressive transfer of wealth from the wealthiest in society to retirees – many of whom have never had access to a State pension before and many others who are living below the Minimum Income Standard – the majority of this money is likely to be spent rather than saved, generating further economic activity.

Equity

It is clear from this Study that the people who least need tax relief to encourage them to save for retirement are the one's receiving relief at the highest rate, and also the ones most likely to avail. Those who most need the encouragement to save for their retirement receive the benefit at a reduced rate, or don't qualify at all. Indeed the OECD (2013, p.150-152) has agreed that there is a misalignment to correct between the existing tax deferral structure in Ireland that provides

higher incentives to high-income earners and the policy goal of increasing coverage, especially for middle to low-income people. As Sinfield (1997) put it; the greatest beneficiaries are those who have the least needs by any measure used in social policy analysis.

According to Collins and Walsh (2010, p.1) a consequence of such policy initiatives is that government is required to then redistribute the burden of taxation across others not availing of that tax expenditure, or to decrease the provision of public services given the reduced overall tax-take.

Sensitivity Analysis

This Study acknowledges that the results borne out in Chapter 6 are subject to variation, depending on the assumptions used in the calculations. Therefore the final version of this working paper will includes other possible outcomes based on changed assumptions for migration, inflation and wage growth. These outcomes, as currently calculated, are summarised in table 7-1, with figures referring to the net annual cost of the proposal in 2042 – the year in which the net effect on expenditure (in current terms) would peak under the USWP using the assumptions discussed in Box 6-1.

Table 7-1 Sensitivity Analysis Summary

Assumption	Net effect on Expenditure (current terms)	Difference to Baseline
Baseline cost	€327,079,711	
Net migration at rate M1	€291,157,275	-€35,922,436
Net migration at rate M3	€354,963,325	€27,883,614
Inflation at 3%; wage growth at	€430,882,151	€103,802,440
Inflation at 4%; wage growth at	€566,099,459	€239,019,748
Pension increases (under current system) equal to wage growth	-€708,304,252	-€1,035,383,963

Different migration assumptions as hypothesised by the CSO cause the cost to fluctuate by less than €36 million per annum in 2042.

Inflation and wage growth are the factors with the most potential to affect the projections, though increased costs due to rising price levels – the USWP being linked to the Minimum Income Standard which is driven in part by inflation – are offset to a degree by the potential savings in tax reliefs in a time of increasing wages. It is clear, however, that inflation is the main driver of cost for the proposal.

Interestingly, were the government to link the current State pension to the rate of wage growth and not inflation from 2015 – as has been proposed in the past – the USWP would actually prove much cheaper in the long-run, whilst

maintaining living standards for the elderly under the Minimum Income Standard.

Conclusion

There is no argument that encouraging people to put money aside for their retirement is not a desirable aim of government and though we have already noted the tendency of tax relief on pension contributions to re-direct savings, it is still likely that these reliefs have *some* positive effects on retirement-savings take-up. However, this aim must be balanced against the cost to the Exchequer and perhaps more importantly against the opportunity cost of such expenditure. While the current tax relief regime engenders some economic benefits, it does so at a high price while the implementation of the USWP would also serve as an economic stimulus. This Study has shown that at least *some* of the tax expenditure could be used to better forward the stated aims of the pension system, while not adversely affecting anyone earning less than €32,800 per annum.

The findings of Chapter 6 are subject to variation, depending on changes in economic and demographic circumstances. However, Table 7-1 illustrates that no reasonable variations in the assumptions used affect the projections in such a way as to make the USWP unaffordable. Implementation of the USWP would improve the performance of the pension system from the point of view of financial equity, poverty elimination, gender equality, efficiency and predictability. It would also expand pension coverage in a manner which even mandatory enrolment policies would not be capable of.

It would do all this at no extra cost to the public finances in the short-term, while the long-term cost in current terms is both affordable and sustainable when one considers the scope for raising additional funding through the pension system, the likelihood of an economic recovery by the time such costs arise, and the laudable achievements that would result from the implementation of the proposal.

8. Conclusion & Recommendations

Purpose & Findings

The aim of this Study was to develop an understanding of what a pension system should do; to propose a change to the system that would improve performance in this regard; and show that such a change could achieve its aims in a manner that is not detrimental to the long-term sustainability of the system or to the public finances.

Throughout the Study, it has been emphasised that the primary purpose of a pension system is to allow the elderly in society to retire from work with an acceptable standard of living. Having measured the extent to which this being is achieved and suggested ways in which the system could be bettered, it has been shown that it is possible to greatly improve the system's performance using primarily money that is already invested in the system. In fact under the projections in Chapter 6, the increase in State expenditure on the system as a whole would peak at an extra 3.8% per annum in current terms, while still leaving tax incentives to encourage individuals to save for their retirement.

The changes proposed by this Study would also help improve the system's performance in areas other than poverty relief. The Universal Social Welfare Pension would also;

- Make the system more financially equitable.
- End discrimination in the pension system on grounds of gender and work-type.
- Bring universal pension coverage to Ireland.
- Increase administrative efficiency and predictability for the State.
- Increase certainty for individuals planning for their retirement.

Recommendations

This Study views the impending demographic changes in Ireland as a challenge to be met; not an excuse to renege on society's duty to its vulnerable via means such as expenditure cuts, or further emphasis on market-based alternatives which have been shown[54] to fail in meeting their objectives in the overall context of pension systems.

There have been calls from several sources – among them the Commission on Taxation (2009, p.230) and Collins and Walsh (2011) – for better measurement and data collection on the costs and benefits of tax expenditures. However, enough information already exists to show that pension-related tax expenditures

[54] See analyses of Chile and Australia in Chapter 3.

are to a great extent inequitable and failing to achieve results that justify their expense.

Spicker (2008, p. 210) writes that one of the principal methods of policy development is to focus not on what ought to work but on what does. Given the high opportunity cost and regressive nature of the tax expenditures analysed, this Study recommends a reduction in the extent to which they are used to encourage retirement savings via the private pensions system. It is also recommended that the savings be used to increase coverage among the elderly by the State pension and increase the amount of the payment to a level where the elderly are no longer at risk of experiencing poverty. This can be done by universalising the State pension, and increasing it to a level that it has been shown can sustain an elderly person.

The proposal contained in this Study is ambitious, financially significant and yet necessary in order to remove the anomalies that have been allowed to persist in relation to pension coverage; to reduce the inequities within the system; to remove gender-based discrimination; and to eliminate poverty among the most vulnerable in our society. The projections contained in this Study help illustrate what might be possible with the money that is already being invested in the system. This Study acknowledges that given the vested interests involved, the additional expenditure required and the overriding emphasis on expenditure cuts under the current government, it is unlikely that the proposal will be considered in its entirety – at this time, at least. However, it is hoped this Study will contribute to and influence the debate on what constitutes a meritorious pension system.

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Appendices

Appendix A – Tax Facts

Table A-1 Income Tax Brackets

Income Tax 2013	
Standard Rate	20%
Marginal Rate	41%
Standard Rate Band	
Single/Widowed	€32,800
No dependent children	€32,800
With dependent children	€36,800
Married – one income	€41,800
Married – two incomes *Increase is lower of €23,800 and income of lower earning spouse	€41,800 + €23,800

Figures from the Citizen's Information website

Table A-2 Tax relief on Pension Contributions

Age of contributor	Limit (% of net relevant earnings)
Up to 30	15%
30-39	20%
40-49	25%
50-54	30%
55-59	35%
60+	40%

Figures from the Department of Social and Family Affairs (2010, p.38)

The amount of earnings which can be taken into account for the purposes of tax relief on pension contributions is €115,000 per annum.

Appendix B – Justification of the Use of the Minimum Income Standard

Current debates about the eradication of poverty are deemed by Collins, McMahon, Weld and Thornton to be insufficiently informed by socially agreed empirically based income standards. 'They have been developed by negotiation between policy-makers at national level and not by informed social consensus about what households need in order to have a minimum essential standard of living. Poverty is officially measured through income and deprivation measures, but these are not based on a standard of living which meets a household's minimum essential needs'. Hence the need to establish a minimum income standard for Ireland based on the minimum needs of household types across the lifecycle.

The consensual budget standards method was used to provide a socially agreed upon minimum standard of living, which society agrees it is unacceptable to expect people to live below. This standard is arrived at through consensus, as focus groups of real people are used to obtain the necessary data for each household type in urban and rural areas, combining people from different economic and social backgrounds to establish the minimum requirements for households to live at an acceptable level and participate in society. The focus is on needs, not wants.

The previous research, establishing the minimum expenditure baskets for six household types, provided the foundation upon which the most recent study is built. The four key stages to the research in this report are

1. Expansion of the coverage of the Minimum Essential Standard of Living (MESL) budgets across the lifecycle, by adding three new individual types
2. Individualising the data from the pre-existing aggregate household types, to facilitate examining a more representative range of household types across the lifecycle
3. Assessment of the adequacy of social welfare supports and the national minimum wage for household types at each stage of the lifecycle
4. Where these income levels were found to be inadequate the minimum income required for each household type is established.

The report seeks to establish the cost of a minimum essential standard of living across the lifecycle. When the data from the six existing households used in previous calculations is updated and combined with that from the three new individual types the most recent report provides data on the essential living requirements of individuals across the entire lifecycle from children to pensioners.

The report also undertakes a process of individualising existing aggregate household data. The individualised expenditure data is adjusted to the same

pricing point as the newly gathered data, March 2011, and the MESL requirements of a broad range of household types are established.

The research was undertaken in conjunction with the Vincentian Partnership for Social Justice.

Appendix C – Pensions Tax Reliefs

Table A-3 Amount of Tax Relief granted by Relief Type in 2010

Relief type	**Amount**
Employees' Contributions to approved Superannuation	€599
Employers' Contributions to approved Superannuation	€141
Estimated cost of exemption of employers' contributions from	€515
Exemption of investment income and gains	€835
Retirement Annuity Contracts (RACs)	€180
Personal Retirement Savings Accounts (PRSAs)	€73
Estimated cost of tax relief on "tax-free" lump sum payments	€136
Gross cost of tax relief	**€2,479m**

Figures from the Revenue Commissioners (2012, p.18)

Appendix D – Description of Population Projection Model 2016 - 2046[55]

Projections of the population have been compiled on an annual basis up to 2046. The model used is the demographic component method which projects the base 2011 population forward under the chosen assumptions governing births, deaths and net migration.

The 2011 Census of Population data are first disaggregated by age and sex. The death and gross migration rates which these groups are assumed to experience in the following year are then applied. The assumed fertility rates are applied to the female population aged 15-49. The population projected in this way then becomes the base population for the following year. The whole procedure is repeated.

One hundred different single year age groups are distinguished (0-1 to 99+) for both males and females. After the base population is aged a year the appropriate survivorship ratios are applied to it. Next the assumed migration effects are included. The assumed outward and inward flows are broken down by age and sex on the basis of the distributions estimated for the inter-censal period 2002-2011. This yields the surviving population adjusted for net migration but without an estimate of the number of children born in the year. The age specific fertility rates for the projection year are applied to the projected female population to estimate the projected births. These births are then divided into males and females on the basis of the ratios experienced for recent years. The appropriate survivorship ratios are then applied to male and female births before these are added in to yield the total projected population.

The assumed labour force participation rates are applied to the projected population aged 15 years and over to give the projected labour force.

[55] This description of the model is taken entirely from the CSO's *Population and Labour Force Projections 2016-2046* and is reproduced with permission.

Appendix E – Method of Projecting Mortality[56]

Mortality rates were projected by estimating the current rate of improvement for each sex and assuming that this rate of improvement will decline over a twenty-five year period to a long-term average improvement rate not dissimilar to the rates observed in the long-term past. Analysis showed that the current rate of decline of mortality for males averaged around 3 per cent per annum and around 2.5 per cent per annum for females across most ages. It was assumed that there would be no mortality improvements at ages from 100 years and upwards.

The Expert Group judged it reasonable to apply the same rate of mortality decline for the long-term future estimates for male and female mortality rates and, following reflection, a long term rate of 1.5 per cent per annum was settled upon as not unreasonable for all ages up to age 90 years from 2036 onwards. For each year between 2010 and 2036, the mortality declines for that year were calculated by linear interpolation.

Estimating the current rate of improvement in mortality

- A graduated life table was prepared for 2009-2011 following the same methodology as that employed for previous Irish Life Tables. Comparing these recent mortality rates with those of the last published Irish Life Table (ILT 15 centered on the year 2006) gave the average rate of improvement per annum over the four year period 2006 to 2010 at each age for each sex. (Similar rates of improvement were observed also over the three years to 2010.)
- Projections using the recent age-specific rates of decline in mortality or replacing them with the average rate of 3 per cent per annum for males and 2.5 per cent per annum for females up to age 90 years produced almost identical life expectancies at age 0 years and at age 65 years for each future year. It was decided to adopt the average rate for each sex as the initial rate of improvement to ensure that projected age-specific mortality rates are consistent (so, for example, that projected mortality rates in each future year increase with increasing age at the older ages).
- A zero per cent improvement (i.e. no improvement) was assumed for ages of 100 years and over. For ages 91 years to 99 years, the current rate of improvement was estimated by linear interpolation between the assumed rate of improvement at age 90 years (3% for males and 2.5% for females) and the zero per cent rate of improvement at age 100 years.

Projecting mortality improvements from 2036 onwards

- The average rate of improvement over the 76-year period 1926-2002 was 1.43 per cent per annum for males and 2.1 per cent per annum for females (when calculated as a simple average of the rates of improvement at each age from age 0 years to age 100 years over that period). There is a pronounced age structure effect to the improvements, with the rate of improvement

[56] This description of the method for projecting mortality is taken entirely from the CSO's *Population and Labour Force Projections 2016-2046* and is reproduced with permission.

generally lowering with increasing age. However, over more recent periods, the age pattern is less pronounced with later ages now showing large improvements. Also, in more recent decades, males are recording larger proportionate falls in mortality rates than females.

- It is difficult to settle on an annual rate of mortality improvement assumed to hold from 2036 onwards. Following discussion, the Expert Group decided that an annual decline of 1.5 per cent was reasonable to apply to both sexes up to age 90 years, as it is not very dissimilar to the average rate of mortality decline over the long term past. For ages of 100 years and over, no mortality improvements from calendar year 2036 were assumed. For age 91 years to age 99 years, the rate of improvement was estimated by linear interpolation.

Projecting mortality improvements between 2010 and 2036

- As explained above, the projection methodology estimated the current average rate of mortality decline for the four year period 2006 to 2010 for each sex at each age. This turned out to be approximately 3 per cent per annum for males, and approximately 2.5 per cent per annum for females, up to age 90 years.

For any calendar year after 2036, the reduction in mortality over that year is assumed to be 1.5 per cent for each sex and at each age up to age 90 years. For all years between 2010 and 2036, the mortality declines for that year at each age is a simple linear interpolation between the decline in 2010 and that assumed in 2036. For ages of 100 years and over, no improvements were assumed either now or in the future while for ages between 90 years and 100 years, the rates of mortality decline were estimated by linear interpolation.

Appendix F – Glossary of Terms and some Important Notes

Age specific fertility rate: The age specific fertility rate for a particular age group is the number of live births to women in that age group per 1,000 females in the same age group.

Labour force participation rate: The number of persons at work or unemployed in a particular age group expressed as a percentage of all persons in that age group.

Life expectancy: The average number of additional years a person would live if current mortality trends were to continue. The expectation of life at birth represents the mean length of life of individuals who are subjected since birth to current mortality trends. Life expectancy is usually compiled on the basis of a life table showing the probability of dying at each age for a given population according to the age specific death rates prevailing in a given period.

Net Migration: The net effect of immigration and emigration. A positive entry denotes that inward migration exceeds outward migration and vice-versa.

Pensioner Support Ratio: The ratio of workers to pensioners in the country.

Pensioner Unit: Pensioner units are either single pensioner households where the person is aged 65 and over, or pensioner couples where the male spouse/partner is aged 65 and over (Department of Social and Family Affairs, 2007, p.36).

Replacement rate: The level of fertility required for population to remain static. It is 2.1 children per female.

Standard Fund Threshold: The Standard Fund Threshold (SFT) is the maximum fund allowable on retirement for tax purposes. As of August 2013, it is €2.3 million. When the capital value of pension benefits drawn down by an individual exceeds the SFT, a tax charge of 41% is applied to the excess.

State Pension/State Social Welfare Pension: The bulk of direct pension spending by the Exchequer in Ireland is on the State contributory and non-contributory pensions, and the State Pension (Transition). Except where distinction is necessary, this Study will refer to all three collectively as the State pension or State social welfare pension.

Total fertility rate (TFR): The TFR represents the theoretical average number of children who would be born alive to a woman during her lifetime if she were to pass through her child bearing years (ages 15-49) conforming to the age specific fertility rates of a given year. The rate refers to a theoretical female cohort.

Widow's pension: Refers to both the widow's and widower's pension, as well as to the surviving civil partner's pension.

Many of these explanations, insofar as they refer to terms used in that document, are taken from the CSO's *Population and Labour Force Projections 2016-2046* and are reproduced with permission.

Appendix G – Acronyms & Abbreviations Used

CPI: Consumer Price Index

CSO: Central Statistics Office

DB: Defined Benefit

DC: Defined Contribution

ECB: European Central Bank

ESRI: Economic and Social Research Institute

EU: European Union

GDP: Gross Domestic Product

GNP: Gross National Product

MESL: Minimum Essential Standard of Living

MHDI: Median Household Disposable Income

NPPI: National Pensions Policy Initiative

NPRF: National Pension Reserve Fund

NRA: National Retirement Age

NWCI: National Women's Council of Ireland

OECD: Organisation for Economic Cooperation & Development

PAYG: Pay As You Go

PRSA: Personal Retirement Savings Account

PRSI: Pay Related Social Insurance

PSR: Pensioner Support Ratio

RAC: Retirement Annuity Contract

SERPS: State Earnings-Related Pension Scheme

SIF: Social Insurance Fund

SILC: Survey on Income & Living Conditions

SWP: Social Welfare Pension

TCD PPRG: Trinity College Dublin Pension Policy Research Group

TFR: Total Fertility Rate

USC: Universal Social Charge

USWP: Universal Social Welfare Pension