

SYMPOSIUM ON THE GOVERNMENT GREEN PAPER "A NATIONAL INCOME-RELATED PENSION SCHEME"

DUBLIN MEETING

(Read before the Society, 16 December, 1976)

MAJOR SHORTCOMINGS OF EXISTING PENSION SCHEMES AND FUNDAMENTAL REQUIREMENTS FOR A NEW NATIONAL INCOME-RELATED SCHEME

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INTRODUCTION

I would like first of all on behalf of the Parliamentary Secretary to the Minister for Social Welfare to thank the Statistical and Social Inquiry Society of Ireland for arranging this symposium on the Green Paper entitled "A National Income-Related Pension Scheme". As stated in the foreword, the Parliamentary Secretary hopes that there will be detailed and widespread study and discussion of the ideas contained in the Paper. This is the first discussion of the Green Paper to be arranged since the Paper was published and I welcome the opportunity to outline the main shortcomings we see in the present pension system in Ireland and possible ways in which these might be overcome. In doing so I will try to draw together various questions raised throughout the Green Paper so as to focus the discussion on the issues of major importance. I might mention also that I have tried to avoid trespassing on areas which will be dealt with more appropriately by the second speaker, Mr. Honohan, who provided the necessary actuarial expertise in the preparation of the Green Paper, and to whom we in the Department feel very much indebted.

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INADEQUACY OF COVERAGE

The first major shortcoming of the present situation described in Chapter 7 of the Green Paper, is inadequacy of coverage. First of all the self-employed, who form a very large proportion of the active population, have no rights to pension under the social insurance system and must rely for pensions on the non-contributory social assistance pension schemes or on private arrangements made through insurance companies, etc. The social assistance schemes cover the whole population but, in effect, because payments are subject to a means test, they cater only for those in the lower income groups. When the present system of social insurance, introduced under the Social Welfare Act, 1952, was being formulated it was decided that it was not practicable, mainly for administrative reasons, to extend social insurance on a compulsory basis outside the employee class. The considerations which influenced this decision related to the difficulty of finding workable arrangements for the collection of contributions in the case of the self-employed to take the place of the relatively straightforward system of collection through an employer which exists in the case of employees; it was also considered that inherent differences in the respective ways of life of employees and self-employed persons posed undue problems in relation to the satisfactory administration of benefits and to a proper system of control. The retention of the assistance schemes, relieved as far as possible of objectionable features, was seen as the best solution to the problem at the time. With the social insurance system now covering in effect the whole employee population, and in the light of the experience of the operation of the system over the years, the question of extending social insurance to the self-employed is being considered at present.

Chapter 19 of the Green Paper outlines briefly the present position and raises for discussion some of the problems which arise in considering the question of income-related pensions for the self-employed. This question, however, must be seen in the context of the broader issue of social insurance coverage for the self-employed and, while pensions will constitute the main element of such coverage, it will be necessary to consider in detail a number of questions relating to the broader issue, for example what categories of the self-employed should be covered and what principles should be followed so as to arrive at an equitable spread of the financial burden as between the different sectors covered. The examination of these questions should not hold up the discussion of an income-related pension scheme for employees and, in fact, Part 4 of the Green Paper; is concerned only with the case of employees, though many of the arguments therein will be equally applicable in the case of the self-employed. It is not suggested that discussion of the position of the self-employed be postponed and in fact the Department would welcome views on the question of social insurance coverage in general and of pension coverage in particular for the self-employed, including farmers, who present particular problems in this respect.

As far as employees are concerned the problem of coverage arises in a different way. **Chapter 6** of the Green Paper shows the position in some detail on the basis

of the latest information which was available to us. In the case of the social insurance schemes and of occupational pension schemes in the public sector, the information is comprehensive and up to date. As explained in the Paper, however, the information in respect of occupational pension schemes in the private sector related in some cases to the position in 1973 and for that and other reasons referred to in the Paper, the extent of the coverage in this sector is likely to be understated.

Bearing this in mind we see that there is a very large number of employees (55% of the total on the basis of the figures used) whose only entitlement is to the flat-rate pensions of the social insurance system. Of the remaining 45 per cent the majority are in the public sector where the coverage of occupational pension schemes is relatively high. It must be said of course that many of the schemes in the State-sponsored area of the public sector are provided through insurance companies and other bodies which operate in the private commercial world.

Undoubtedly there are large gaps in coverage as far as employees are concerned and the Green Paper sets out to examine the question of how to ensure that all employees employed in undertakings ranging from the largest to the smallest have access, on basically similar terms, to an income-related pension scheme. Of course coverage does not necessarily mean adequate coverage and this raises many other questions.

LEVEL OF PENSIONS

While there may be general agreement that all employees should have the coverage of an income-related pension scheme available to them, it is more difficult to determine what level of pension should be provided and difficult therefore to find a yardstick against which to measure the adequacy or otherwise of pensions provided at present. It is obvious, however, as is pointed out in Chapter 7, that the flat-rate pensions of the social insurance system cannot of themselves maintain a reasonable relationship with the past standard of living of the recipients in most cases.

In the occupational pensions field there would appear to be wide variations in the levels of pension provided, ranging from the 66.6 per cent level, which is the maximum allowable for approval for income tax reliefs (and which frequently consists of a pension together with a lump sum) down to very low flat-rate pensions supplementing the entitlements under the social insurance system. Provisions in occupational pension schemes for invalidity and survivors' pensions, where they exist, also vary a great deal.

In determining the level of income-related pension which should be provided in a national scheme there are no objective tests, and international practice, as shown in the Paper, varies considerably, each country determining its own levels with due regard to its resources and its conception of its own needs. There seems to be a

trend however towards earnings-related pensions with pension levels between 60 per cent and 80 per cent of variously defined measures of pre-retirement earnings, usually earnings close to retirement. In the Green Paper the 66.6 per cent level is taken to be the optimum that could reasonably be aimed at and two of the model systems presented for illustrative purposes in the Paper are based on this level of pension. This is not, as is stated in a number of places in the Paper, to be taken as a commitment to this level of pension, and any of the model systems can be varied to provide whatever level of pension is desired. The main reason for focussing the discussion on the 66.6 per cent level was that many employees already have, by virtue of occupational pension schemes, rights to pension at that level. If a lower level were set, the option set out in the Paper of a State system absorbing all existing schemes would be ruled out. The setting of a 66.6 per cent level leaves this option open, as well as other options, including contracting out on whatever terms are ultimately considered desirable.

PROTECTION OF PENSION RIGHTS

It is considered essential that people who are building up pension rights should not lose these acquired rights for any reason before they reach pension age. As far as the social insurance system is concerned this presents a problem to the extent that anomalies can occur where a person moves from an employment which is subject to full social insurance where he is covered for all pensions to one which is subject to modified insurance where he is covered only for widows' and orphans' pensions. This can happen for example on promotion in certain employments in the public sector. In the case of occupational pension schemes it may happen that persons who cease to be covered by a scheme on redundancy, change of employment or for any other reason, lose whatever rights they had already acquired. They may be entitled to a refund of any contributions paid by them, where the scheme is a contributory one, but this is not a satisfactory situation. Some schemes do provide for preservation of pension rights where an employee leaves or changes his employment and, in the public sector at any rate, there is also machinery for transfer of pension rights as between certain occupational schemes.

The problem of protection of occupational pension rights also arises in the case of mergers and takeovers which have become a fairly common feature of industrial life in recent times. As mentioned in the Green Paper this particular problem may be dealt with in proposed EEC legislation on the safeguarding of employees' rights in the event of mergers, takeovers and amalgamations.

The protection of pension rights would have to be an essential feature of any new national income-related pensions system. How such protection is provided will-

depend on the type of system which is adopted and, in particular, on the position of existing occupational pension schemes in relation to that system.

INFLATION PROOFING

Apart from the question of the protection of pension rights, the protection of the value of pensions — inflation-proofing as it is called — has become a very live issue in recent times and must receive the fullest consideration in the formulation of any new pensions system. In an income-related pension scheme there are two aspects of inflation-proofing, firstly, the protection of entitlements to future pensions from erosion of value and secondly, the protection of pensions while in payment.

Where pensions are based on final pay the first of these questions does not arise. However where pensions are based on average pay over a period of years they will, in the absence of a protective mechanism, yield a standard of living on retirement which may already be lowered as a result of inflation and fail to reflect the growth of community incomes. A system of revaluation of the earnings on which pension is based or of calculation of pension on a points system is required in order to get over this problem. Revaluation could be done by reference to movements in prices or, if it is decided that the relative position of contributors should be maintained, by reference to an index of earnings. International practice in this matter, as outlined in the Green Paper, varies considerably.

The second aspect of inflation-proofing is the protection of pensions in payment. Such protection can be automatic, where pensions are linked to an earnings or prices index, etc., or non-automatic where protection is by a system of periodic reviews which take into account movements in those variables. Under the social insurance system at present protection of pensions in payment is by way of increases granted in the context of the Budget. As far as occupational pension schemes are concerned provision generally exists for periodic increases in public service pensions by reference to current rates of pay but arrangements of this nature appear to be very rare in the private sector.

In the Green Paper the Model Systems include provision for pensions to be regularly adjusted by reference to changes in average earnings. This does not, however, indicate any commitment to this type or degree of inflation-proofing. Indeed it is made clear in the Paper that protection of pensions against erosion of value is very difficult and may not be possible to achieve fully. The choice may lie, as pointed out in paragraph 161, between a system providing high rates of pension but less than full inflation-proofing subsequent to award, and a system providing lower pensions fully inflation-proofed.

THE ROLE OF OCCUPATIONAL PENSION SCHEMES

In examining the shortcomings of the present pensions situation the Green Paper notes the overall picture as one showing a lack of co-ordination between the various interests involved in the provision of pensions, and points to the need for an overall policy in relation to pensions with a determination of the roles which the various parties involved should play. This immediately raises the broad question of the role of existing occupational pensions schemes in a new system. This is one of the major questions which will no doubt provoke much debate and indeed, on the basis of the submissions which the Department received during the preparation of the Green Paper, is a matter on which there is a fairly clear divergence of views.

In a Resolution adopted by the Annual Delegate Conference of the ICTU in 1974 Congress called on the Government

"to take immediate steps with a view to the introduction of one comprehensive national occupational pensions scheme to supersede all existing pension schemes for employees. Such a scheme should also provide for the use of its substantial funds to promote industrial and economic development".

A very different view was expressed by the Irish Association of Pension Funds in its submission to the Department in January 1975 in connection with the preparation of the Green Paper. The essence of the Association's position, as set out in that submission, was that the Association would be concerned to ensure that any extension of the existing Social Welfare provisions should be directed towards the more needy sections of the community and should not hinder the continuing development of private occupational schemes which have grown considerably in size and scope in recent years. The Association believes that these objectives could be best achieved by a long-term partnership between the State and the private sector. This partnership would, the Association suggested, operate on a two-tiered basis as follows:

- (i) A flat-rate State pension for all employed persons.
- (n) An earnings-related supplementary pension, provided in most cases under a private occupational scheme. Where there was no additional private pension or where this pension was considered inadequate a State earnings-related supplement would be payable.

The Green Paper leaves open for discussion the whole range of possibilities between these two extremes. The only possibility which is ruled out as inadequate (in paragraph 176, Page 82) is one seeking merely to improve the existing flat-rate pensions system and leave pay-related pensions to be provided solely by occupational pension schemes. It is clear, and was accepted by the IAPF in their submission, that there will always be some employed persons who cannot be adequately catered for under private schemes, and a continuation of that position would not be in keeping

with the aim of giving all employees access to an income-related pension.

MODEL PENSIONS SYSTEMS

I would now like to turn to a consideration of possible ways in which a national income-related pension system could operate. This can perhaps best be done by examining in some detail the three model pension systems referred to earlier which the Green Paper puts forward for illustrative purposes. It must be stressed that these systems do not purport to be the only acceptable methods of providing adequate pensions and there is no commitment to any particular method, in whole or in part. They are presented in order to give some idea of the costs involved in a national pensions system under different methods of financing, a matter which will be dealt with in Mr. Honohan's Paper, and to enable the various other implications of such a system to be assessed. To maintain a firm basis of comparability between them, the models have many features in common, e.g., the provision of retirement, invalidity and survivors' pensions, pensionable age of 65 for both men and women, the same definitions of pensionable service and earnings, provision for revaluation of earnings and pensions.

The Models may be more readily followed if we look at pension coverage as comprising a number of tiers. The present system is generally a two-tier one, the first tier being the State flat-rate retirement, invalidity or survivor's pension and the second tier whatever is provided by occupational schemes, with the overall level of income replacement in any particular case depending on a wide variety of factors.

Two of the Model Systems, called Models A and B in the Paper, provide for pensions at the 66.6 per cent level after 40 years' service. Either of these two systems could thus absorb all existing occupational schemes or could on the other hand allow for occupational schemes to contract out.

Model A is in effect a single-tier system with pensions purely earnings-related and not differentiated between single persons and persons with dependants, but with a guaranteed minimum pension equivalent to the person's flat-rate entitlement under the present system including increases for dependants. Model B is a two-tier system in which the present entitlements actually form the first tier of pension coverage, the second tier being an earnings-related supplementary pension; the total pension for a single person being set at the 66.6 per cent level. In the case of persons with dependants, of course, the flat-rate entitlement when added to the supplementary pension would bring the overall pension over the 66.6 per cent level. As I have said, both of these Models can provide pensions at a level high enough to allow all existing schemes to be absorbed, and on the other hand, both are capable of being adapted to allow occupational schemes which provide adequate pensions to contract out. Contracting out could be total - where employees would be wholly excluded from the national system - or partial, where they would be excluded from

the upper tier in a two-tier system.

The third Model System, Model C, is specifically designed to allow a significant role to be played by occupational pension schemes without the complications of a system of contracting out. This system would be a two-tier State system, the first tier being the existing flat-rate pension, including increases, the second tier being an earnings-related supplementary pension. The system would provide earnings-related pensions for all employees but only on pay up to a certain level, leaving a third tier of pension related to the upper levels of pay to be provided exclusively by occupational pension schemes.

A number of features are common to each of the Model Systems including the assumption that the normal pensionable age would be 65 for both men and women. Bearing in mind that any new system would have to protect existing entitlements, each of the Model Systems provides by way of either a guaranteed minimum pension or a basic pension, the retirement pension at present payable under the social insurance system, and it is further assumed that periods of insurance under the existing social insurance system would be converted into appropriate pensionable service under the new system.

Three types of pension are provided under each of the Model Systems. Retirement pension is payable at age 65 subject to retirement. A retirement condition applies at present in the case of the retirement pension under the social insurance system and it can be argued that where pension is in replacement of lost income, it should only be payable where there is such a loss. As mentioned in the Paper it is a matter for decision whether or not there should be a retirement condition or whether an earnings rule should apply, under which pension would be reduced by reference to any concurrent earnings.

Survivors' pensions under the Model Systems consist of widow's pension, payable as under the present system on the basis of the widow's or her late husband's insurance, and widower's pension which would be payable to a widower who is permanently incapable of work and has been wholly or mainly maintained by his deceased wife. Provision for the latter type of pension exists in other countries and consideration should be given to the need for similar arrangements here. The rate of survivor's pension in each of the Model Systems is related to the rate of retirement pension but that relationship varies from half the retirement pension which would have been payable to the deceased in the case of Model A, to the full retirement pension in the case of Model C. The relationship between the rates of retirement and survivors' pensions, in the context of a new earnings-related pension system, and whether or not this should vary having regard to the age or dependency situation of the survivor, are matters which arise for consideration in this regard.

The third type of pension provided in the Model Systems is invalidity pension which would be payable to a person who is permanently incapable of work. This

is the same condition as applies under the social insurance system at present but the question may be asked whether in a new system the incapacity should be such as to render the person completely incapable of any work or whether illness or incapacity to an extent sufficient to require retirement on grounds of ill-health would suffice. The rate of invalidity pension under each of the Model Systems is the same as the rate of retirement pension.

Each of the Model Systems provides that the full earnings-related pension would be payable after 40 years' service, with a proportionate pension where the length of service was less than 40 but not less than 10 years. As far as the guaranteed minimum or basic pension is concerned, however, the minimum qualifying service would be ten years' pensionable service in the case of retirement pension and three years' service in the case of invalidity pension, widow's pension or widower's pension. These requirements reflect the qualifying conditions under the present system where it is possible to qualify for a retirement pension on the basis of ten years' insurance and for invalidity or widow's pension on the basis of three years' insurance.

In the case of invalidity and survivors' pensions the Model Systems include provision for added service. In the case of survivor's pension where the insured person has had at least three years' pensionable service, that service is increased by the number of years remaining to age 65, and in the case of invalidity pension a person with not less than 10 years' but less than 40 years' pensionable service may have that service increased by 20 per cent subject to certain conditions. These latter provisions are related to similar provisions which exist at present in certain occupational schemes in the public sector.

The earnings on which the earnings-related pension is based in each of the Model Systems is the highest yearly average of pensionable earnings which can be calculated over any 10 years of pensionable service, with the earnings being revalued in line with the movements in average earnings. Final earnings might appear to be the most suitable yardstick against which to calculate pension but in some cases earnings fall in the later years, having peaked at an earlier stage in the working career and it may be considered that a system on the lines of that used in the Model Systems gives a reasonably true reflection of earnings in all cases.

The question also arises as to whether there should be a ceiling on the amount of earnings to be taken into account. This would not arise where the new system was designed to replace all existing pension provisions and Models A and B do not explicitly provide for any such ceiling. Such a ceiling could of course be built into either of those systems and Model C, which is explicitly designed to leave considerable scope for occupational pension schemes, provides for a ceiling set at approximately the level of average male industrial earnings.

There are two other aspects of pensions which are not specifically included in the model systems but which will have to be considered. The first is the question

of paying retirement pension in advance of normal pensionable age or of deferring the drawing of pension until after that age. A number of European countries make provision in their pension systems for such flexibility of pension age, with limits of five years before and five years after the normal pension age. Appropriate reductions or increases in pension could be applied in these cases.

The second is the question of the possibility of crediting pensionable service to a woman who leaves employment to look after a family and whose service for pension purposes would otherwise be diluted. It is an underlying principle in the Green Paper that there should be equality of treatment as between men and women in relation to pensions. The question of women leaving employment in the circumstances mentioned is, however, a special problem, and consideration will have to be given to the possibility of special arrangements in such cases.

CONCLUSION

In presenting this paper this evening I am very conscious of the fact that you may well regard the presentation as being unsatisfactory in so far as I have not put before you a specific set of considered proposals which you could analyse, and indeed criticise, in some detail. My defence is that it is not possible for me to do this having regard to the position as outlined in the foreword to the Green Paper, namely that "The Government are not committed to any of the options contained in the Paper — all of which are put forward for consideration, assessment and discussion". To a large extent, therefore, I am merely posing questions, and we look to bodies such as your Society to provide us, if not with complete answers, at least with considered views which will help us to arrive at acceptable conclusions.

Finally, I would like to say to any member of the Society who may have a special interest in this subject, that we would be glad to consider any submission he may wish to make, or to arrange meetings to discuss and clarify any of the issues" involved.