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Irish Congress of Trade Unions

Total Contributions Approach Consultation:
Submission on behalf of ICTU

July 2018

Introduction

The Irish Congress of Trade Unions is pleased to accept the invitation to make a submission to the consultation on the Total Contributions Approach and to outline the views of Congress on the design parameters of the scheme to be introduced to calculate entitlement to the State Pension (Contributory).

Congress is the largest civil society organisation on the island of Ireland, representing and advancing the economic and social interests of some 800,000 workers across the economy.

Congress recognises the anomalies and inconsistencies within the existing method of assessing entitlement to the contributory pension, and agree in principle with a move to a Total Contributions Approach.

The key issues for Congress in switching to an assessment system based on total contributions can be categorised under a number of headings:

I. The qualifying years for a full pension
II. The implementation date
III. The cap on credited contributions
IV. The treatment of caring responsibilities
V. The paid contributions test
VI. Benchmarking and index-linking the payment rate
VII. The qualifying age

These are discussed in detail in the following sections.

Replacing Yearly Average with a Total Contribution Approach

Under the current averaging system, which has applied to the contributory pension since its introduction in 1961, a key qualifying condition is the applicant's yearly average of social insurance contributions.

This yearly average is calculated by dividing the number of contributions by the total number of years making contributions, i.e. from the date the applicant first enters social insurance to their last contribution year before reaching pension age.

Yearly averages are grouped into rate bands and each band has a corresponding rate of payment. The higher an applicant's yearly average, the higher the level of payment awarded. There is no pension entitlement for those with less than 10 years contributions.

A significant anomaly arises in the averaging system where a long gap outside of the workforce or insurable employment reduces the yearly average, which in turn reduces the pension payment. For instance, if an applicant first became insured in 1970, then left her job in 1972 to marry and raise a family before returning to employment in 2000, her average number of contributions would be divided by 48 (the number of years between 1970 and 2018). In effect, the weekly pension payment would be markedly higher had she not worked 1970-72.

A second inconsistency is that two people with the same total number of contributions can get paid different amounts because of differences in the length of time over which those contributions were made. Similarly, a person with a high number of contributions can get the same amount or less than another person with significantly fewer contributions.

These anomalies worsened from 2012 when two new rate bands were introduced and the amount paid on yearly averages of less than 40 contributions were lowered to, according to the Department: 'more closely reflect the social insurance contribution history of a person than those in place'.[1]

Calculating pension entitlement using a Total Contributions Approach would eliminate these anomalies and inconsistencies in that the totality of an applicant's contributions – as opposed to the timing of them – determines the size of the pension payment.

Accordingly, Congress agrees in principle with adopting a Total Contributions Approach to replace the current Yearly Average method for assessing entitlement to pensions.

Qualifying Years

Government is proposing that 40 years of social insurance contributions, 2080 contributions in total, be required to qualify for a full pension under the Total Contributions Approach. Applicants with fewer than 40 qualifying years would receive pro-rata payments, i.e. 1/40th of a pension awarded for each full year of contributions. A minimum rate pension would remain in place, proposed at 10/40ths i.e. one-quarter of the full pension, discussed in more detail in a later section.

[1] Department of Employment Affairs and Social Protection (23 January 2018 p.2) *Detailed Questions and Answers* https://www.welfare.ie/en/downloads/Pensions_PolicyOptionsReporton2012RateBands_Q+A.pdf

Congress rejects the proposed 40 qualifying years for a full pension, on the grounds that:

(i) It is technically possible in the current yearly average system to qualify for a full pension based on as little as 10 years of contributions, 520 contributions in total.

(ii) In 2010, eight short years ago, when the then Government set out its framework for comprehensive reform of the pension system it committed to: 'a total contributions requirement of 30 years contributions for a maximum pension will be introduced'.[2]

(iii) At the same time, in 2010, the qualifying years required to receive the full State pension in the UK was significantly reduced from 44 years for men and 39 years for women to 30 years for both[3]. Given our proximity and history, the UK is the country to which our social policies most closely align. Ireland also has Bilateral Social Security Agreement with the UK that allows people move between the two countries without losing their pension entitlement.

(iv) In the most recent actuarial review of the financial position of the Social Insurance Fund, which covers a 55 year period from 2016 to 2071, three out of the four scenarios costed for the introduction of TCA are calculated on 30 qualifying years.[4]

(v) A 40 years target fails to recognise that the impact of historical structural issues are still evident in the contribution records of older workers. Specifically, comprehensive social insurance coverage is less than 30 years in place[5] and pervasive societal norms kept the vast majority of married women outside of the workforce long after the marriage bar was revoked in 1973[6].

Taking into consideration the above, Congress recommends that the 30 qualifying years for a full pension originally committed to by Government in 2010 is a more equitable and appropriate requirement than the 40 years now being proposed.

However, Congress' support for 30 qualifying years is conditional on Government accepting a further recommendation (see next section) that an option to calculate pension entitlement under the averaging or total contributions method must remain in place after 2020 for people at a stage of

[2] Government of Ireland (2010) *National Pensions Framework* Dublin: The Stationery Office p.21
[3] From 2016, 35 years contributions are now needed to qualify for the full pension.
[4] The fourth scenario was costed on 35 qualifying years, KPMG (September 2017) *Actuarial Review of the Social Insurance Fund 2015* Appendix 7 https://www.welfare.ie/en/downloads/actrev311215.pdf
[5] In 1974 insurable income limits for non-manual workers were abolished. Social insurance coverage was extended to the self-employed in 1988; part-time workers in 1991, and new public servants in 1995.
[6] It was more than 30 years after the lifting of the Marriage Bar before married women's employment reached 50 per cent for the first time - 53 per cent in 2006.

their life where they can do very little to improve their contributions record and who have a reasonable expectation that their future state pension entitlement would not change significantly.

Congress further recommend a regular contribution statement be issued to people to inform them of their total contributions to date.

Implementation Date

Earlier this year, the Minister for Social Protection, Regina Doherty announced that post-2012 pensioners adversely affected by the changes to the rate bands could have their pension entitlement calculated by averaging or total contributions, and be awarded the higher pension of either method[7].

This option is to be withdrawn in 2020. Thereafter, the Total Contributions Approach will be the only method of assessment available to applicants reaching pension age.

Congress rejects the proposal to implement the Total Contribution Approach by 2020.

A 2020 start date does not take account of legacy issues, such as limited social insurance coverage and the low participation of women in paid employment, which negatively impacted the potential of older applicants to accumulate contributions.

Indeed, Government recognised this in its 2010 plans for the introduction of a Total Contributions Approach:

> Research for the Green Paper, and further analysis undertaken since, has shown that the gaps in social insurance coverage which existed in the past are still apparent in the insurance records of those qualifying for pension today. The introduction of the total contributions approach at this stage would, as a result, see reduction in the level at which pensions are paid[8].

On foot of this, Government took the decision to delay implementation until 2020: 'when the social insurance reforms undertaken from 1974 will be evident in the records of those who will be then reaching pension age'[9].

[7] The Department has not yet released figures on how many people will benefit, and to what extent, from this measure.
[8] Government of Ireland (2010) *National Pensions Framework* Dublin: The Stationery Office p.22
[9] *Ibid:* p.22

However, this 2020 implementation date was premised on 30 qualifying years for a full pension, not the 40 years now proposed.

In addition, three out of the four scenarios costed in the latest actuarial review of the financial position of the Social Insurance Fund include a 'guarantee' that pensions will be at the same rate or no less than 90 per cent of a pension calculated under the averaging system for pensioners retiring five or ten years after the implementation of the Total Contributions Approach.[10]

Taking all of the above into account, Congress recommends the option to calculate pension entitlement under the averaging or total contributions method must remain in place after 2020 for people at a stage of their life where they can do very little to improve their contributions record and who have a reasonable expectation that their future state pension entitlement would not change significantly.

Credited Contributions

Credited social insurance contributions, commonly referred to as 'credits', are awarded to insured workers who may not be in a position to pay contributions due to certain contingencies - sickness, invalidity, unemployment, maternity, caring, participating in specified training schemes, strikes and other miscellaneous circumstances.

The objective of credits is to preserve a worker's insurance record and their future entitlements by covering, for a limited duration, gaps in income from employment.

Where a person has no paid contributions for two years, they cannot be awarded further credits until 26 contributions (6 months) are paid. The rationale being there should be a reasonable link between entitlement to contributory benefits and recent participation in the active labour force. There is currently no limit on the number of two year intervals for which credits can be claimed.

A 10-year, 520 contributions, cap on credits for non-caring prescribed reasons over an applicant's working life is now proposed, in line with what was proposed in the 2010 Government commitment to the move to a Total Contribution Approach.

[10] KPMG (September 2017) *Actuarial Review of the Social Insurance Fund 2015* Appendix 7 https://www.welfare.ie/en/downloads/actrev311215.pdf

A maximum 20 years is currently disregarded when calculating entitlement for applicants who left the workforce after 1994 due to caring commitments. Under the Total Contributions Approach a new credit will recognise caring periods prior to 1994, discussed in more detail in the next section.

Congress rejects the proposed 10-year limit on the durations for which credits can be claimed.

Retaining the 10-year cap on credits while simultaneously proposing to increase the qualifying years for a full pension from 30 to 40 years will in effect reduce the value of this provision from one-third to one-quarter of the full pension payment.

Congress recommends an increase in credits proportionate with any increase beyond 30 qualifying years for a full pension, in order to maintain the level of protection of workers' insurance record committed to in 2010.

Congress further recommends broadening the education and training opportunities covered to include credits for workers at risk of displacement from technology and sustainable production for periods outside of the workforce to upskill and retrain. Social insurance needs to reflect the realities of deindustrialisation and a just transition to a low carbon economy.

Caring Responsibilities

A Homemakers Scheme was introduced in 1996 with the aim of protecting the pension entitlement of applicants leaving the workforce due to caring commitments. Each full tax year out of work to care is ignored or disregarded when calculating entitlement, up to a maximum of 20 years.

Under the Total Contributions Approach, in place of the disregard, a new HomeCaring Credit will provide up to 20 years credits, 1040 contributions in total, to applicants raising children up to age 12 or providing full-time care and attention for a sick or incapacitated person of any age.

There will be a cap of 20 years on the total number of all credits which can be used in calculating an applicant's pension entitlement, e.g. 12 years caring, 4 years unemployed, 4 years sick.

Congress notes that the new HomeCaring Credit:

(i) Has no limitation on backdating caring periods, unlike the existing Homemakers Scheme which does not recognise periods before 1994.

(ii) The retention of the 20 year period for caring duties is a significant improvement on the 10 years cap which Government, in 2010, committed to implement as part of a move to standardise all credits[11].

(iii) When compared to the length of caring periods allowed for pension purposes in other EU member states, which are generally very short, 20 years is comparatively favourable but remains closely aligned with the approach adopted by the UK.

Congress further notes that certain categories of public servants, who have no entitlement to claim a State Pension and who have taken time out of the workforce to care, are not awarded similar credits for pension purposes. Consequently, their occupational pension can be less than a full State Pension, in contrast to the floor inbuilt in the public service sick pay scheme.

Congress acknowledges the HomeCaring Credit as reasonable provision for preserving the pension entitlement of carers.

Paid Contributions Test

In order to qualify for any contributory welfare payment, including pensions, applicants must have a minimum number of *paid* contributions in order to meet the 'first condition' or 'paid contribution' test[12]. This ensures no applicant is awarded any social insurance income based wholly on credits.

Under legislation passed in 1997 which came into effect in 2012, pension applicants need to have 520 paid contributions, a minimum 10 years over their working life i.e. they don't have to be consecutive years[13]. Applicants who reached pension age before 2012 and after 2002, required 260 paid contributions, a minimum 5 years.

The 2012 doubling of the paid contribution requirement disqualified applicants who would previously have qualified for a reduced pension. Applicants without the adequate contributions can apply for a non-contributory pension, which is means-tested on both their and their spouse's income and capital. Due to the income disregards, over 70 per cent qualify at the maximum rate which is 95 per cent the value of the full contributory pension[14]. For those with a significant household income, a more advantageous option is to claim as a dependent on their spouse's pension, i.e. as a Qualified

[11] Government of Ireland (2010) *National Pensions Framework* Dublin: The Stationery Office p.23
[12] Government of Ireland (2007) *Green Paper on Pensions* Dublin: The Stationery Office p.79
[13] Prior to 2002, 156 paid contributions was sufficient.
[14] Oireachtas Joint Committee on Social Protection (July, 2017) *Review of State Pension (Contributory)* p.6

Adult, which is 90 per cent the value of the full pension, as this is based solely on the means of the Qualified Adult.

The paid contributions qualifying condition was abandoned in the UK in 2010. Applicants now receive 1/35th of the full rate for every 52 contributions, whether paid or credited contributions. As such there is no minimum rate pension and no distinction between paid contributions and credits.[15]

Under the Total Contributions Approach, Government propose retaining the qualifying condition of 520 paid contributions and the minimum reduced pension, proposed at 25% of the full rate.

Congress recommends, at a minimum, Government reinstate the pre-2012 minimum of 5 years paid contributions.

Congress further recommends Government conduct cost-benefit analysis of abolishing the minimum rate payable to applicants with paid contributions and instead award 1/30th of the full rate for every 52 contributions paid.

This analysis should also explore removing a paid contribution condition for credits, as in the UK.

Benchmarking and Index-Linking the Payment Rate

A key objective of the pensions system is to ensure people are not living in poverty in retirement. For almost half of all pensioners, 47 per cent, the State pension is their only source of income.

A person whose income is less than 60 per cent of the national median income (€12,227 per annum or €235.13 per week, in 2016[16]) is officially defined as 'at risk of' living in poverty, as their income is inadequate for them to have a standard of living that is regarded as acceptable by Irish society.

As of from 30 March 2018, the full pension payment rate is €243.30 per week i.e. equivalent to 34 per cent of average weekly earnings of all employees in 2017 as calculated by the CSO, and marginally above the poverty line. People aged over 65 are now four times less likely to experience poverty compared to the population as a whole.

Ireland is unusual in setting the pension payment rate in the budget every year without use of a formula. In Britain, for example, a 'triple lock' is in place since 2010 whereby the pension increases annually by the rate of inflation, wage growth or 2.5 per cent, whichever is the greater. However,

[15] Bozio, A. et al (2010) *The history of state pensions in the UK: 1948 to 2010* Institute for Fiscal Studies Briefing Note BN105 pp. 15-17

[16] CSO (19 December 2017) *Survey of Income and Living Conditions (SILC) 2016 Results*

this guarantee is now viewed by the UK Government to be unsustainable – estimated to cost £45 billion over the next 15 years, and has been criticised by the OECD for: 'putting one group in society [pensioners] on a pedestal over another'[17]. That is, a formal guarantee limits Government discretion to implement other policy priorities and spend on other groups outside the pension system.

Government is proposing to maintain the current rate by formally setting a benchmark for the pension payment at 34 per cent of average earnings of all employees and to index link future increases in payments to increases in prices and wages. This 'double-lock' will ensure pensioners' income is not eroded by the gradual increase in the cost of living.

Congress supports the moves to provide pensioners with greater income certainty on the value of their pension via legislation and the indexation of pension rates.

Congress recommends that in index-linking future increases in the pension to increases in prices account is taken of goods and services disproportionally consumed by older people.

Congress views the proposed target of 34 per cent of average weekly earnings as calculated by the CSO to be a floor below which the value of the pension will not fall and not as a ceiling above which it cannot surpass, as finances allow.

Qualifying Age

When the contributory pension was first introduced in 1961, the qualifying age was 70 years. At the time, life expectancy was, on average, 68 years for men and 70 for women. A State Pension (transition) was also introduced to bridge the gap for workers who had to retire at 65. There was, and there continues to be, no statutory retirement age in Ireland[18]. Throughout the mid-1970s, the pension age was gradually reduced to 66 years, which left the transition pension effective for just one year.

Government is in the process of increasing the qualifying age. From 2014, the transition pension was discontinued and the pension age increased to 66 years. It is scheduled to increase to 67 years in 2021 and to 68 years in 2028. Government is now committing to no further increases prior to 2035,

[17] Josephine Cumbo (27 April 2017) 'UK should scrap state pension for the rich, says OECD' *Financial Times* https://www.ft.com/content/8b4de636-2a79-11e7-9ec8-168383da43b7

[18] Retirement age and pension age are two separate concepts. The age at which an individual retires is a matter for agreement with each contract of employment and the employer/ employee relationship.

other than those already provided for. Thereafter, changes will be directly linked to increases in life expectancy with no less than a 13 year lead-in before coming into effect[19].

Congress calls on Government to reverse its decision to implement increases to the pension age[20].

There was no public engagement or consultation with worker representatives on the implications of increases to the pension age. Instead, Government unilaterally implemented the changes, claiming:

> There is a strong underlying policy basis to these changes. They are underpinned by demographic changes and concerns regarding the sustainability of pensions. […] What this means is that people need to participate in the workforce for longer and need to contribute more towards their pensions [21].

Earlier this year, the Department again stressed that more people are living to pension age and, when people reach pension age, they are living longer. Specifically, the number of people reaching age 65 years is projected to double over the next 30 years, from 586,000 to 1,193,000. Irish men aged 67 today can, on average, expect to live for a further 17 years and Irish women for a further 20 years. Simultaneously, according to the Department's projections, pensioner support ratio is forecasted to fall from 4.9 workers per pensioner in 2015 to 2.7 workers per pensioners in 2045[22].

While increases in the pension age are taking place in many countries, Ireland is currently on course to have the highest pension age in the OECD in 2028[23]. Yet, we currently have the second lowest pensioner to worker dependency ratio in the EU27[24]. Furthermore, life expectancy is not uniform across socio-economic groups. For example, in the past 10 years in the UK, the Office of National Statistics began measuring levels of deprivation with longevity. For the male population, the gap in life expectancy between the poorest and most advantaged was almost a decade, standing at 73 years and 11 months and 83 years and four months respectively[25].

Workers contractually required to retire at 65, as well as workers physically unfit to continue in their job beyond 65, must now claim Jobseeker's Benefit or, for those with insufficient contributions,

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[19] Government has stated that it will do the first review of State pension age in line with life expectancy in 2022, which would allow for an increase in 2035.

[20] Since 2015, three OECD countries - Canada, the Czech Republic and Poland – have reversed previously adopted increases to the pension age, OECD (2017) *Pensions at a Glance 2017* p.22

[21] Oireachtas Joint Committee on Social Protection (February, 2014) *Implications for employees of changes to the pension age: Opening Statement of Dr Orlaigh Quinn, Department of Social Protection* pp.2 and 7

[22] WRC 'The World of Work' Conference (February, 2018) *Pensions Policy Developments: Presentation by Tim Duggan, Department of Employment Affairs and Social Protection* slide 5

[23] OECD (2017) *Pensions at a Glance 2017* p.22

[24] Eurostat News Release (08 May 2018) 'Record high old-age dependency ratio in the EU' http://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20180508-1?inheritRedirect=true

[25] May Bulman (01 March 2018) *Life expectancy of poorest girls in England falls for first time on record since 1920* London Independent

Jobseeker's Allowance. Where a jobseeker is 65 years the duration of the Benefit continues until their 66th birthday, even if their claim is due to end before that date[26]. With effect from 22nd March 2018, the Jobseeker's Benefit payment rate is €198.00 per week, i.e. €45.30 per week or €2,355.60 per annum less than a contributory pension. In addition, entitlement to the Household Benefits Package to assist with utility costs, worth €590 per annum, and free travel on public transport are pushed out in line with the pension age. People, in their mid- to late-60s, with no secondary pension or ineligible for Jobseeker's Allowance will be most severely impacted.

Pension policy in some European countries recognise the young age at which workers in manual occupations enter full-time employment, compared to college-educated professions, and who are less likely to be physically capable of extending their working lives. For example, in 2014, Germany lowered the pension age by four years, to 63 years, for workers who had 45 years of paid contributions, i.e. people who had started working straight out of school and had paid social insurance every year since. Similarly, the programme for government of the new Italian coalition pledges to allow people to draw their state pension once the 'sum of their age and years of contribution is equal to 100'[27].

Accordingly, Congress recommends Government immediately reinstate the State Pension (transition).

Congress recommends Government abandon its plan for two further increases to the qualifying age and commit to a public consultation on steps to address the challenges of population ageing and the financial sustainability of the pension system.

Congress recommends lowering the qualifying age for workers who entered employment at a young age and have had a long working life.

Summary and Conclusions

Congress recognises the anomalies and inconsistencies within the existing method of assessing entitlement to the contributory pension, and agree in principle with a move to a Total Contributions Approach.

The key issues for Congress on the final design of the model to be introduced are as follows:

[26] The normal duration for Jobseeker's Benefit for claimants under 65 years is 6 months for those with 260 contributions or less and 9 months for those with more than 260 contributions.
[27] (18 May 2018) 'Italy's coalition: the main policy pledges' Financial Times https://www.ft.com/content/32b1daf6-5abf-11e8-bdb7-f6677d2e1ce8

I. Congress rejects the proposed 40 qualifying years for a full pension.

Congress recommends the 30 qualifying years originally committed to by Government in 2010 to be a more equitable and appropriate requirement.

However, Congress' support for 30 qualifying years is conditional on Government accepting recommendation II, below.

Congress further recommend a regular contribution statement be issued to people to inform them of their total contributions to date.

II. Congress rejects the proposal to implement the Total Contribution Approach by 2020.

Congress recommends the option to calculate pension entitlement under the averaging or total contributions method must remain in place after 2020 for people at a stage of their life where they can do very little to improve their contributions record and who have a reasonable expectation that their future state pension entitlement would not change significantly.

III. Congress rejects the proposed 10 years ceiling on credited contributions.

Congress recommends an increase in credits proportionate with any increase beyond 30 qualifying years for a full pension, in order to maintain the level of protection of workers' insurance record committed to in 2010.

Congress further recommends broadening the education and training opportunities covered to include credits for workers at risk of displacement from technology and sustainable production for periods outside of the workforce to upskill and retrain. Social insurance needs to reflect the realities of deindustrialisation and a just transition to a low carbon economy.

IV. Congress acknowledges the HomeCaring Credit as reasonable provision for preserving the pension entitlement of carers.

V. Congress recommends, at a minimum, Government reinstate the pre-2012 minimum of 5 years paid contributions.

Congress further recommends Government conduct cost-benefit analysis of abolishing the minimum rate payable for applicants with paid contributions and instead award 1/30th of the full rate for every 52 contributions paid.

This analysis should also explore removing a paid contribution condition for credits, as in the UK.

VI. Congress supports the moves to provide pensioners with greater income certainty on the value of their pension via legislation and the indexation of pension rates.

Congress recommends that in index-linking future increases in the pension to increases in prices account is taken of goods and services disproportionally consumed by older people.

Congress views the proposed target of 34 per cent of average weekly earnings as calculated by the CSO to be a floor below which the value of the pension will not fall and not as a ceiling above which it cannot surpass, as finances allow.

VII. Congress calls on Government to reverse its decision to implement increases to the pension age in 2021 and 2028.

Congress recommends Government immediately reinstate the State Pension (transition).

Congress recommends Government commit to a public consultation on steps to address the challenges of population ageing and the financial sustainability of the pension system.

Congress recommends lowering the qualifying age for workers who entered employment at a young age and have had a long working life.