Initial Response of the Irish Congress of Trade Unions to the OECD Review of the Irish Pension System (Preliminary Version) - April 2013

This report of almost 160 pages took 12 OECD consultants more than a year to produce. It will require detailed consideration and analyses before Congress can give a definitive response to all the issues raised. What follows is an initial response to the main findings and recommendations of the review. However, even this perusal of findings and recommendations, makes it clear to Congress that so called 'affordability' has displaced any consideration of the avoidance of poverty amongst our older citizens.

There is no recognition that requiring citizens to pay for their pension poses an obligation on government or indeed on private companies to ensure people get what they pay for. Nowhere in the review is there any recognition that the withdrawal of State pension entitlement or the massive losses sustained by workers in their occupational pension schemes has caused a crisis of confidence in pensions that will take a generation to put right. In the few places where the report identifies inequality as a problem it is with a view to achieving equality of disadvantage rather than improving the lot of our older citizens.

The report - if acted on - will change Ireland's approach to the welfare of older people. The society envisaged by the values underpinning this report would, to paraphrase W.B. Yeats in 'Sailing to Byzantium', produce a society which will be "no country for old people."

Structure of the Congress Response

The structure of this response is to outline the OECD findings and recommendations as they appear in the report and make observations on them individually or to cluster findings or recommendations for response as appropriate.

The main findings are listed on pages 10 and 150 of the review as follows:

OECD Finding:

- Ireland is facing challenges on the financial sustainability of the pension system as the population ages; despite large projected increases in expenditure over the next 50 years, however, Ireland's pension spending will still be comparatively low in international comparisons.

Congress Comment:

Congress has often challenged the unscientific use of demographic assumptions as a guide to pension planning. In spite of the OECD's apparent desire to give us bad news they are forced here to admit that our "projected spending will still be comparatively low by international standards.2

OECD Finding:

- The economic situation of pensioners in Ireland is comparatively good, both with respect to other age groups in the population and in international comparison.

Congress Comment:

This situation has come about through a determined effort by successive governments and Irish civil society to improve the relative position of older people in our society. However the recent decision to withdraw pension entitlements to a greater level and a faster pace than the rest of Europe signals the unravelling of this long standing consensus.

OECD Finding:

- Ireland and New Zealand are the only OECD countries which do not have a mandatory earnings-related pillar to complement the State pension at basic level. As a result, Ireland, like New Zealand, faces the challenge of filling the retirement savings gap to reach adequate levels of pension replacement rates to ward off pensioner poverty.

Congress Comment:

This ignores the fact that worker and employer PRSI contributions are earnings related. In recent times the Government has chosen to change the rules on entitlements to PRSI pensions. The OECD seems to have missed the implication this has for confidence in the system. The doctrine of legitimate expectation has been shredded. It appears that any pension contribution can simply be pocketed by a government or a private provider so long as they can claim inability to pay. This runs totally contrary to the principle that a person who makes their contributions has a legitimate expectation to accrued benefits.

OECD Finding:

- Private pension coverage, both in occupational and personal pensions, is uneven and needs to be increased urgently.

Congress Comment:

There has been a consensus on this matter since the early 1980's. However the acceptance of this consensus has its dangers as it tends to rule out any serious consideration of providing *a funded pension through the State system. It also misses the point that occupational and private pensions in Ireland have lost credibility. Private pensions can work as an excellent tax dodge for the rich, but occupational pensions are regarded by most active and deferred members as extremely risky and very poorly regulated. It would appear the European Court of Justice shares that view.*

OECD Finding:

- Pension charges by the Irish pension industry on large occupational DC plans are not too high when assessed on an international context; they are however rather expensive for small occupational schemes and personal pension schemes.

Congress Comment:

This is a restatement of the recent finding of the report commissioned by the department.

OECD Finding:

- The existing tax deferral structure in Ireland provides higher incentives to save for retirement to high incomes as the incentives work through the marginal tax rates.

Congress Comment:

Congress has been pointing this out for years. However middle income earners get some relief at the marginal rate and this is important for the survival of many Defined Benefit (DB) schemes.

OECD Finding:

- The Irish legislation regarding the protection of DB plan members is weak. For example, the guarantee schemes in Ireland (Insolvency Payment Scheme and the Pensions Insolvency Payments Scheme) provide partial protection to DB plan members' benefits in case of sponsor insolvency. In addition, the legislation allows any sponsor to 'walk away' from DB pension plans, shutting them down, without creating a high priority debt on the employer. Moreover, the priority currently given to pensioners before other members if a scheme winds up creates large inequalities across members. This outcome is particularly harsh for those close to retirement.

Congress Comment:

The point about the priority currently given to pensioners is well made and timely. Congress and other stakeholders have submitted several papers on this point directly to the Minister. The point about sponsors walking away without incurring debt on the employer needs to be treated with the upmost caution. If the OECD is hinting that Government should introduce debt on the employer legislation then most employers who are currently struggling to keep their schemes going will be tempted to close them in advance of any such legislation.

OECD Finding:

- There is unequal treatment of public and private sector workers due to the prevalence of defined-benefit (DB) plans in the public sector and defined contribution (DC) plans in the private sector.

Congress Comment:

Before the crisis, arguments regarding equality were used to improve the lot of those who were being treated less favourably. The OECD and their advisors seem to see observations on inequality as a vehicle for worsening the quality of life for all our citizens. This amounts to equality of disadvantage.

OECD Findings:

- The State pension system lacks transparency, both with respect to the calculation of benefit entitlements and to the interplay of the contributory and non-contributory pensions.

- The link between contributions and benefits in the Irish State pension scheme is very weak, for reasons spelt out in the report, contrary to what people's perceptions of this link may be.

Congress Comment:

These rather trite truisms are an ill–disguised attempt to justify reducing the pension of people who spend some time out of the workforce. The target here is women and other vulnerable workers. It was interesting that the Minister implied that these findings laid the *basis for a progressive reform. The Minster spoke repeatedly of the need to protect women and vulnerable workers as if she had not presided over the greatest ever attack on these workers in September 2012.*

OECD Finding:

- The State pension scheme could be modernised to encourage working longer in line with the prevailing international trend.

Congress Comment:

By 'modernised' the OECD mean that more pension entitlement should be taken from workers because they believe that encourages longer working. The fact that Ireland is withdrawing more entitlement from workers and doing so faster than any other country in Europe should have made the OECD reluctant to suggest we need to go further still.

Like their advisors in the Department they pay no attention to the labour market issues which would need to be addressed if their so called modernisation is not to result in growing poverty for workers who are to be thrown out of employment with no pension entitlement. A system that seeks is to withdraw entitlement is not modernisation, rather it is going back to the old days of poverty.

OECD Finding:

- The new scheme for public servants is being phased in only very slowly and is unlikely to affect a majority of public sector workers for a long time.

Congress Comment:

Congress believes that equitable pension reform requires a long lead-in period in order to maintain confidence in the system and to vindicate as far as possible the principle of legitimate expectation. The OECD seems concerned that Public Sector workers are not losing their entitlements quickly enough.

II. OECD Main Recommendations for Reform of Pensions

Parametric changes in the State pension system:

Within the existing State pension system, Ireland could consider a number of parametric reforms which would improve the financial sustainability of the pension system in the future.

OECD Recommendation:

- The long-term retirement age - which at 68 is relatively high in international comparison - could be linked to life expectancy after 2028 in order to ensure that improvements in life expectancy do not significantly extend the duration of retirement.

Congress Comment:

The OECD gives no reason why Ireland should treat is older people worse than any other country in Europe.

A parametric change might be not to pay anyone any pension whatever before death. However it might be hard to explain to workers and employers why they are making such high levels of PRSI payments.

OECD Recommendation:

- To provide incentives for workers to remain in the labour market longer and on the other hand provide more flexibility in making the retirement decision, increments and decrements of the State pension could be introduced for early and late retirement.

Congress Observation:

Congress would favour such an approach. However there is a real danger that workforce elites such as academics and those working in financial services would benefit most while workers such as scaffolders, roofers, bricklayers, and cleaners would be very unlikely to be able to work into their early seventies and beyond.

The government introduced the increase in the State pension age change but have not said whether its own employees will be allowed to stay in employment after age 65. Congress has had discussions with employers who have expressed great reluctance to let employees work longer. The Department of Social Protection has been told this but have done nothing whatever to address the problem

OECD Recommendation:

- More flexibility could also be provided in allowing retirees to combine work income and pension receipt; this could also ensure better adequacy of retirement income.

Congress Observation:

Congress agrees with this recommendation.

OECD Recommendation:

Looking ahead, the adjustment of pensions – which have been frozen in recent years – also needs to be considered as this has a large impact on the evolution of pensions in payment; various options of combining indexation to wage growth and price inflation could be considered.

Congress Comment:

Congress agrees with this recommendation.

III. OECD Recommendations for Structural Reform of the State Pension System

OECD Recommendations:

- Given the complex structure and the inequities resulting from the benefit calculation method in the public pension scheme and the interplay between the contributory pension, the non-contributory pension and other means-tested elements of retirement income provision, Ireland should consider a structural change of the State pension scheme.

- At a minimum, the current inequities in the treatment of workers' contributions to the system should be removed and all contributions made should be honoured in the calculation of the pension benefit, as foreseen in the current plans to adopt a total contributions approach from 2020 onward.

- The best two options out of the three described in the report, for a structural reform of the State pension scheme are: a universal basic pension or a means-tested basic pension. Both of these options would have the advantage, compared with the existing scheme, of introducing a much simpler, more transparent and less costly public pension scheme.

Option 1: A Universal Basic Pension Scheme:

- A universal basic pension scheme for the entire population would be based on residency requirements, provide a single flat-rate benefit and cover all of the Irish population, regardless of their life-time work or contribution status. It could be financed by taxes, contributions or a combination of the two.

- A basic pension scheme could be complemented with either mandatory private pension provision or auto-enrolment into private pension schemes. Participation could be targeted at workers above a certain income level as workers on low earnings would already be receiving a comparatively high replacement rate through the basic pension.

- The household benefits package and free travel scheme could either be transformed into a cash supplement and merged with the basic pension or it could be awarded to pensioners who need the extra benefit as a means-tested cash supplement.

- Setting the level of such a basic pension for all citizens in order to meet the twin goals of social adequacy and financial sustainability would require more detailed analysis, including the costing of alternative revenue scenarios.

Option 2: A Single Means-tested Pension:

- An alternative would be a single means-tested pension financed out of general revenue. The household benefits package, the free travel scheme, and other means tested 'advantages' would be included in the pension amount.

- The main design issues to be addressed under such a scheme would means-tested 'advantages' would be included in the pension amount.

- The main design issues to be addressed under such a scheme would again be the appropriate level of the means-tested benefit, at what schedule the benefit should be withdrawn for higher earnings, what type of administrative arrangements would be needed and how much this scheme would cost under alternative scenarios.

- Combining the public and the private pension pillars, a means-tested scheme would function best in combination with mandatory participation in private pension plans. In a voluntary scheme, even with an auto-enrolment mechanism, there would be disincentives to contribute to a private pension, unless a certain amount of pension savings were exempted from the means-test for lower-earning groups.

Congress Comment on the above:

It is outside the scope of an initial response such as this to attempt a comprehensive evaluation of various alternative proposals for restructuring the state pensions system. However to describe a calculation system which seeks to maximise the entitlements of the less well off as an inequity appears to Congress as an abuse of the English language. A calculation system that penalises people for periods of un-employment, illness, caring, child rearing is the very essence of inequity. This is what the OECD implies and the approach was lauded by the Minister at the launch of the review. It is no advantage to a person with full pension entitlement to see their under- unemployed or ill fellow worker denied entitlement in the name of equity.

OECD Finding:

Reform of the public service pension scheme:

- At a minimum, a faster phase-in of the new rules of the occupational scheme for public servants should be considered; this would entail including existing public servants in the new scheme based either on a certain cut-off age or on length of service.

- Any new private pension scheme for private sector workers should also be extended to public servants, at a minimum for new entrants but ideally also for some of the existing public servants.

Congress Comment:

Public servants pay a 5% contribution for their pensions plus 2% (if they have children) plus 7% pension levy. Recently a reform agreement designed to protect accrued rights and vindicate legitimate expectations was agreed through collective bargaining. Pension reform, to have any sense of equity, must be underpinned by these principles. The OECD recommendation in this light can only be seen as vexatious. In relation to the provocative nonsense in the second bullet point perhaps the cosseted experts in the OECD and our multi pensioned government Ministers might lead by example.

Policy Options to Expand Private Pensions Coverage and Retirement Savings

OECD Recommendations:

- To increase adequacy of pensions in Ireland, there is a need to increase coverage in funded pensions. Increasing coverage can be achieved through: 1) compulsion 2) soft-compulsion, automatic enrolment, and/or 3) improving the existing financial incentives.

- Compulsion, according to international experience, is the less costly and most effective approach to increase coverage of private pensions (*OECD Pensions Outlook*, 2012, Chapter 4).

- Automatic enrolment is a second-best. Its success in increasing coverage depends on how it is designed and on its interaction with incentives in the system.

- The cost of establishing and managing auto-enrolment may be higher. Auto enrolment requires monitoring, accurate record-keeping, fiscal incentives and careful design. Implementing a centralised institution to manage the system and provide default investment options would add to the costs.

- 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.

- International evidence (Germany, Australia, and New Zealand) suggests that flat subsidies and matching contributions increase incentives to save for retirement for middle to low incomes.

- Existing private schemes need to be subjected to the same rules as the new schemes under auto-enrolment or compulsion.

Congress Comment:

In spite of the many pitfalls Congress is of a mind to support compulsory pension contributions from workers provided employers are obliged to match contribution. However the action of Government in recent times in withdrawing State pension entitlement willy-nilly wherever it felt it could get away with it creates the worst possible climate for this debate. The failure of the private pension industry to deliver the pension workers and employers paid for begs the question why should we throw good money after bad. The total failure of the regulatory system which has now been de-facto admitted by the abolition of the Pension Board also contributes to making this a challenging prospect.

The OECD suggests the new system should be placed in a private sector that has no credibility. However the general tone of this Review is such as to make Irish workers and pensioner believe that the OECD did not come here to help. It came with a neoliberal political *agenda to do as much damage as possible to the principle that after a long worker life people should enjoy comfort in their old age.*

Improve the design of Defined Contribution arrangements:

- The design and institutional set-up of DC pension plans need to improve in line with the OECD Roadmap for the Good Design of DC Pension Plans.
- Establish appropriate default investment strategies, while also providing choice between investment options.
- Establish default life-cycle investment strategies as a default option to protect those close to retirement against extreme negative outcomes.
- Encourage annuitisation as a protection against longevity risk. For example, a combination of programmed withdrawals with a deferred life annuity (e.g. starting payments at age 85) could be an appropriate default.
- While still keeping the principle of pension savings being "locked away", the Irish Government could consider.
- Specialised private institutions (e.g. pension funds, asset managers) should manage the assets. The establishment of an autonomous public option could be envisaged to provide competition, lower costs, and a default pension fund for those unable or unwilling to make investment or fund choices.

Congress Comment on the above:

Most of the above looks on the surface reasonable. However the suggestion that specialised private institutions should be allowed to manage anything will appear very strange to Irish taxpayers and particularly those with experience of the private pension industry.

Enhancing benefit security in DB schemes:

- Strengthen the Irish legislation regarding the protection of DB plan members when plans wind up. For example, healthy plan sponsors should not be allowed to "walk away" from DB plans unless assets cover 90% of pension liabilities. This funding requirement would introduce some type of guarantees for members and it would allow at the same time some degree of risk sharing. The funding ratio should be calculated following prudent standard actuarial valuations. Moreover, the priority currently given to pensioners before other members if a scheme closes because of sponsor bankruptcy should be eliminated.

- Further legal reforms may be needed to introduce more flexible DB plans that for instance allow for accrued benefits to be cut in case of underfunding (e.g. the Netherlands) and, more generally, for risks to be shared between plan members and pensioners, as well as plan sponsors.

- Establish a clear framework to facilitate domestic investment in infrastructure projects, but a general subsidy to all infrastructure projects should be avoided as it would distort capital allocation. It is clearly desirable that pension funds should help support economic growth in Ireland, but the objective should not be used as an excuse to impose low returns on pension fund members.

- Revise the new funding standards as they may create new risks for pensioners by offering strong incentive for pension funds to invest in government bonds, in particular sovereign annuities.

Congress Comment:

Most of the above is hard to disagree with but the first bullet point will appear strange to those who understand the Irish DB situation. Many pension deficits are a great deal bigger *than the sponsoring employer. Debt on the employer rather than protecting the pension will result in the worker losing his /her job as well as his/her pension.*

Conclusion

The Irish Pension system in in a terrible crisis and needs both a thorough review and wide-ranging reform. The reform should be carried out in a spirit of social dialogue rather than by diktat, as was the recent withdrawal of State pension entitlement.

Changes should be gradual in order to give people time to adjust. Most of the people who are to lose the transitional pension next year were not even told what is about to happen to them. Decisions on withdrawal of entitlement must take into account labour market reform. The principal of legitimate expectation must be protected as much as possible. Changes must be fair and not just based on what government thinks it can get away with. Congress is of the view that the most of the findings and recommendations of the OECD are of little value.

Irish Congress of Trade Unions,

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