Pension Policy Research Group Annual Conference
June 17th 2022

The Pensions Commission Report: Some Unresolved Issues

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The Problem: The Social Security System as currently operated is unsustainable

- The Pensions Commission Report (published in Oct. 2021) mostly deals with State social security pensions, but the recommendations have implications for the pension system as a whole.
- The Government have yet to issue a response to the Report.
- The main issues identified are:-
- (1).. A rise in life expectancy and in the number and duration of those in receipt of State pension payments (Pensions Commission report, p. 9);
- (2).. A rise in the dependency ratio from 5.0 in 1991 to 2.3 in 2051.;
- (3).. A rise in the deficit in the Social Insurance Fund (SIF) from a forecast deficit of €2.36 billion in 2030 to €21.1 billion in 2070.
- This deficit in the absence of change will have to be financed by the exchequer.

Proposed Solutions: Increase the Retirement Age

- The Pensions Commission Report recommended increasing the State pension age to 67 by 2031, starting in 2028 and to 68 in 2036.
- ICTU do not support the proposal to increase the State pension age.
- The Oireachtas Joint Committee also rejected this proposal and recommended the pension age should remain at 66.
- The Oireachtas Joint Committee does support measures which would facilitate working beyond the retirement age for example legislation to ban mandatory retirement clauses.
- This measure is also supported by ICTU.
- The Pensions Commission Report also proposed that those with long contribution histories (45) years would not be required to work beyond the age of 65.

The Proposed Solution: Increase PRSI

- The Report notes that PRSI contribution rates (employer plus employee) at 15.05% are far below the EU average of 38% (Report p. 155).
- The report recommends an increase of 1.35% in employer and employee social security rates from 2030 and 0.1% increase by 2050.
- This recommended increase has had broad acceptance, for example from ICTU (https://www.ictu.ie/news/report-pensions-commission-ictu-view) and the Joint Oireachtas Committee Report ((https://www.gov.ie/en/publication/6cb6d-report-of-the-commission-on-pensions/ .
- Currently persons over the age of 66 do not pay PRSI on their earned or unearned income.
- The Commission proposed that retired persons should pay PRSI at a reduced rate of 4%.
- This change was recommended on the basis of intergenerational equity.
- This proposed change was not been welcomed by trade unions and others.

Intergenerational Equity

- The Pensions Commission has some references to this issue, but various comments on the Pensions Commission Report do not.
- There are substantial differences in wealth between younger and older age cohorts, in terms of pension entitlements and ownership of housing.
- Higher income households may have entitlements/pension payments from two occupational sources and may have other sources of pension income such as AVC's.
- Lower income households have entitlements/pension payments from only one source – the State Old Age pension
- These differences are likely to persist.
- For example, the median age of a single person house purchase was 42 in 2019 compared with 34 in 2010 (https://www.cso.ie/en/releasesandpublications/fp/fp-cropp/characteristicsofresidentialpropertypurchasers2010-2019/ageofpurchasers/.
- House prices are now 7 times average earnings, thus making house purchase impossible for those on low incomes.
- House price inflation plus high rents mean it is difficult to accumulate sufficient resources to enable house purchase.
- Low returns, for example negative interest rates on bonds have reduced returns to pension assets and increased capital sums to provide adequate pensions in retirement.

Solutions: Auto-Enrolment

- Although the focus was on State pensions the Pensions Commission advocated an automatic enrolment pension system.
- The Commission Report states (p. 74) “the early introduction of automatic enrolment, which will introduce a funded component to the pension system and improve retirement income adequacy for future pensioners”.
- The problem is that those in low pay sectors (accommodation and food, wholesale and retail) are also most likely to be those without or have low pension coverage.
- They are most likely not only to have inadequate savings for house purchase, but also to have little disposable income because of high rent charges.
- The Joint Oireachtas Committee Report noted:-
- “that auto-enrolment could involve significant investment in pensions by the State, and stated “Exchequer funding should not be prioritised over the retention of the State Pension age at 66”.

Pension Reform and the Rise in Inflation

- The rate of price inflation has been increasing steadily since April 2021 and rose to 8.2% in the year to May 2022.
- It is likely to remain high (> 5%) for some years.
- The Pensions Commission did not anticipate and hence discuss the return of inflation for pension systems and pensions in payment.
- Inflation affects pensions in a number of ways.
- Pension funds will be adversely affected.
- Figure (1) shows real yields on government bonds (nominal yield minus the rate of price inflation) for the period May 2016 to April 2022.
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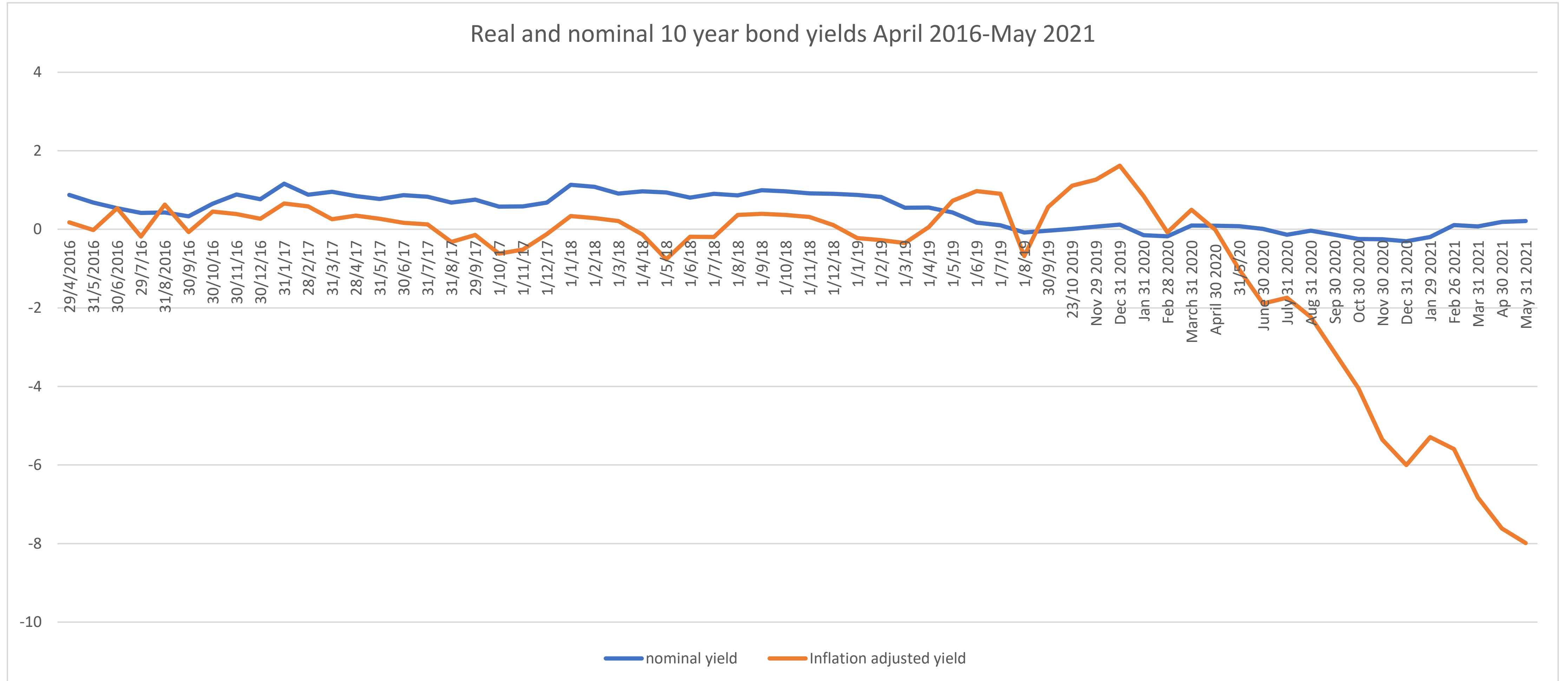
The Real Yield on Irish 10 Year Government Debt



The proportion of Bonds in pension Fund Portfolios

- The effect of negative real yields and associated fall in bond prices (as price movements are inverse to yields) depends on the proportion of bonds in pension fund portfolios.
- The Table below shows that Defined Benefit schemes are particularly adversely affected.
- According to Pensions Board data Government and other debt amounted to 45.1% of total assets in 2020.

	DB Assets[1]	Gov. and other debt %[1]	Pensions Board Data%[2]	DC Assets[1]	Gov. and other debt %[1]	Total Assets IAPF Data
2020	N.A.	N.A.	45.1	N.A.	N.A.	
2019	94.0	42.1	44.6	59.9	22.6	153.9
2018	90.7	40.8	42.0	52.6	22.9	143.3
2017	91.2	35.5	40.6	56.4	20.6	147.6
2016	77.9	36.9	42.4	47.6	22.8	125.5
2015	71.3	39.0	41.8	43.7	23.6	115.0

What About Stock Market Returns ?

- Stock markets have become more volatile in response to rising Central Bank interest rates in an attempt to curb inflation and the ending of bond purchases by the ECB and other Central Banks.
- Fig (1) shows considerable volatility in the ISEQ index since 2014.
- Although returns from investing in equities are not the same as index movements they are correlated.
- Fig (1) shows the ISEQ index on 22nd June, 2022 to be at a very similar level to June 1st 2001.
- Indices for several other EU countries show similar patterns, for example the Netherlands

The ISEQ Index June 1998-June 2022

Some Effects

- DB schemes will not be in a position to match pension increases to likely increases in salary.
- Benefits from DC schemes will not match expectations.
- It is likely that individual funded pension schemes, such as existing PRSA's will face similar problems.
- The net result will be an increase in dependence on social welfare pensions.
- Those on fixed pension incomes such as State pensions will experience a large drop in real income. Those with real assets such as equities and housing may benefit.
- There may also be adverse effects within the working population.
- Wages in some sectors may match inflation, while in other sectors nominal wages are much more rigid implying a fall in real wages.
- The Social Insurance Fund (SIF) is likely to show an increase in revenues because of rising wages.
- Increases in pension benefits are likely to lag wages, thus resulting in a growing surplus in the SIF.

Conclusions

- Policy making over the long run, as with pension systems is difficult.
- Future forecasts for example, demographic projections particularly for Ireland, are uncertain.
- A State administered PAYG system based on solidarity and consensus is the best solution to future pension provision, while recognising an important role for occupational pensions.
- Given the need for change, policy should proceed now on the basis of what can be agreed, for example those who wish to extend their working career should be enabled to do so.
- This requires “careful analysis” and new legislation (Report of the Pensions Commission p. 119).