Pension Policy: New Evidence on Key Issues

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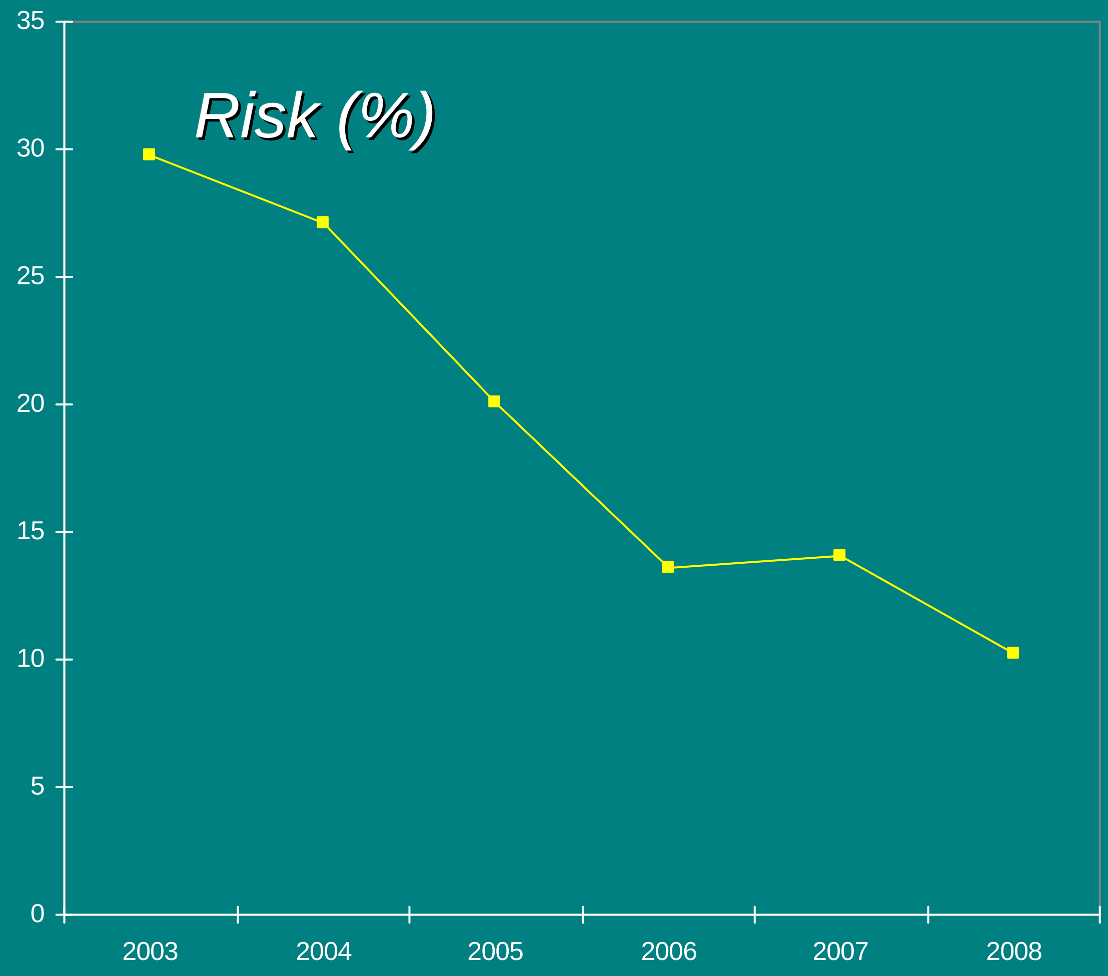
Overview

- *Context*
- *Framework for the analysis*
- *Pensions and incentives*
- *Public sector pension levy*
- *Policy options*

Older persons “at risk of poverty”



At risk= living on an income below 60% of median disposable income adjusted for household size and composition (“equivalised”)

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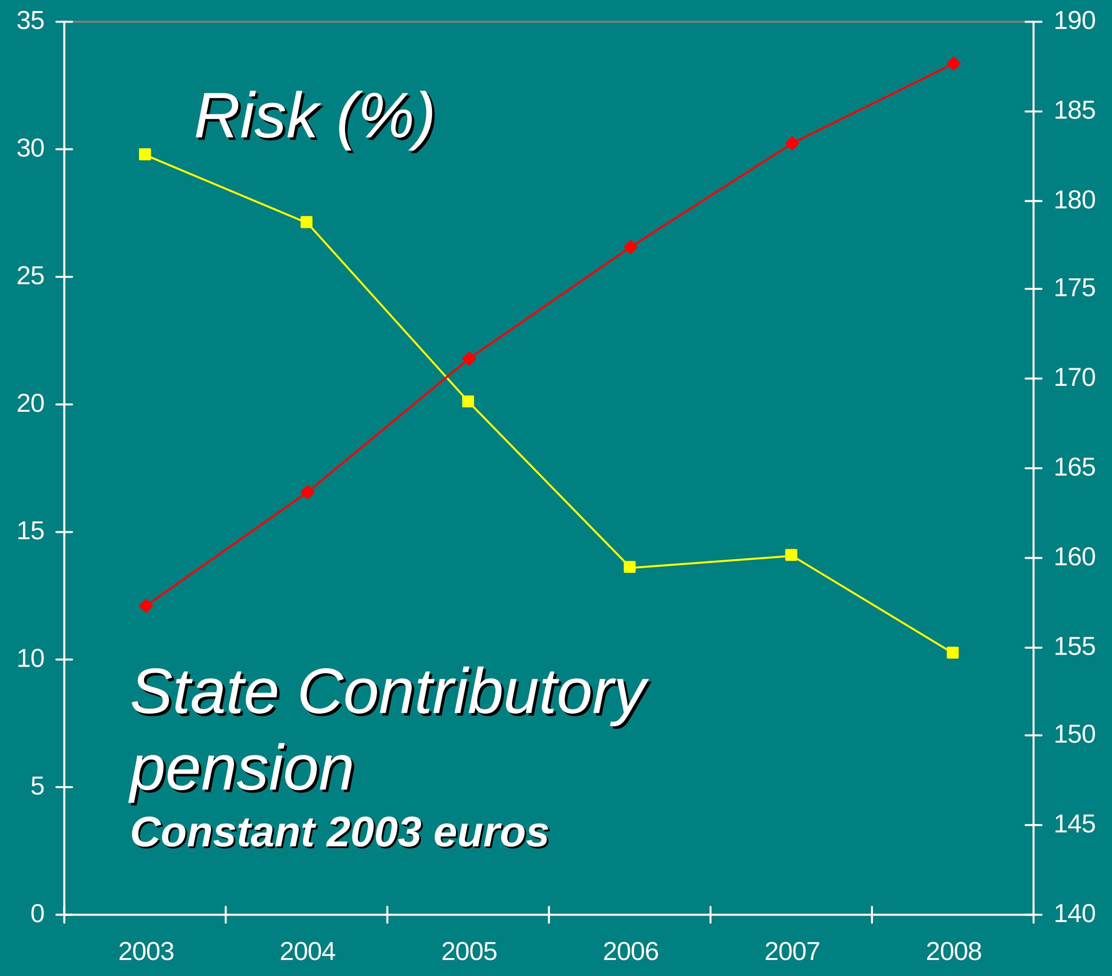

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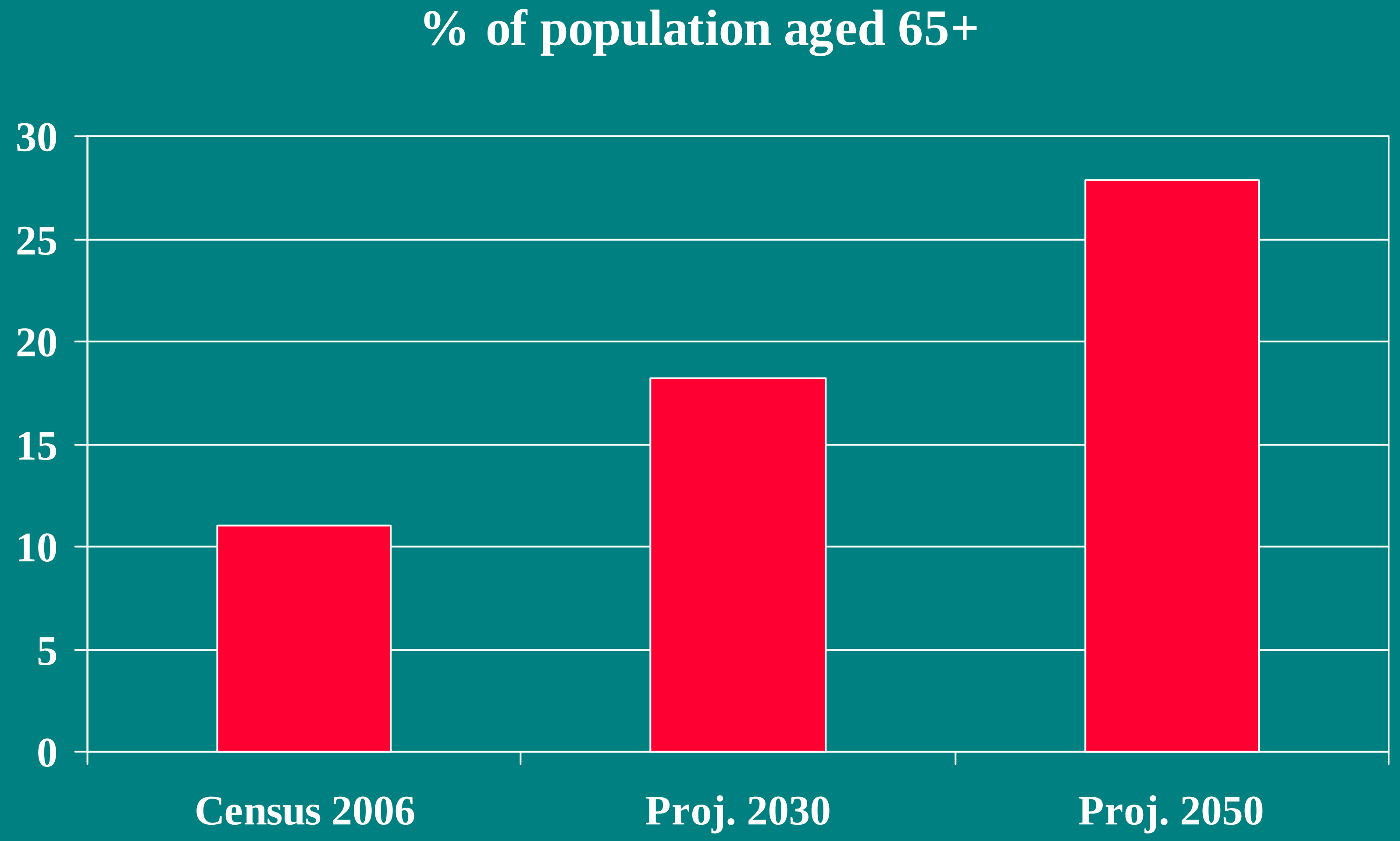
Demographic context



International evidence

- *How effective are tax incentives in boosting pension saving?*
  - *Substantial “deadweight losses” especially at high incomes - would have made pension savings even in absence of tax incentives*
- *Double taxation?*
  - *overrsimplified: real world tax systems have to compromise between conflicting principles*
  - *Latest thinking: Given that labour income is taxed, what is the best way to tax capital income*

Framework for the analysis

- *SWITCH, the ESRI tax-benefit model*
  - *calculates welfare entitlements and tax, PRSI liabilities of a nationally representative sample*
- *Adjusted to take account of demographic developments*
  - *so policy impact can be assessed for future years as well as current circumstances*

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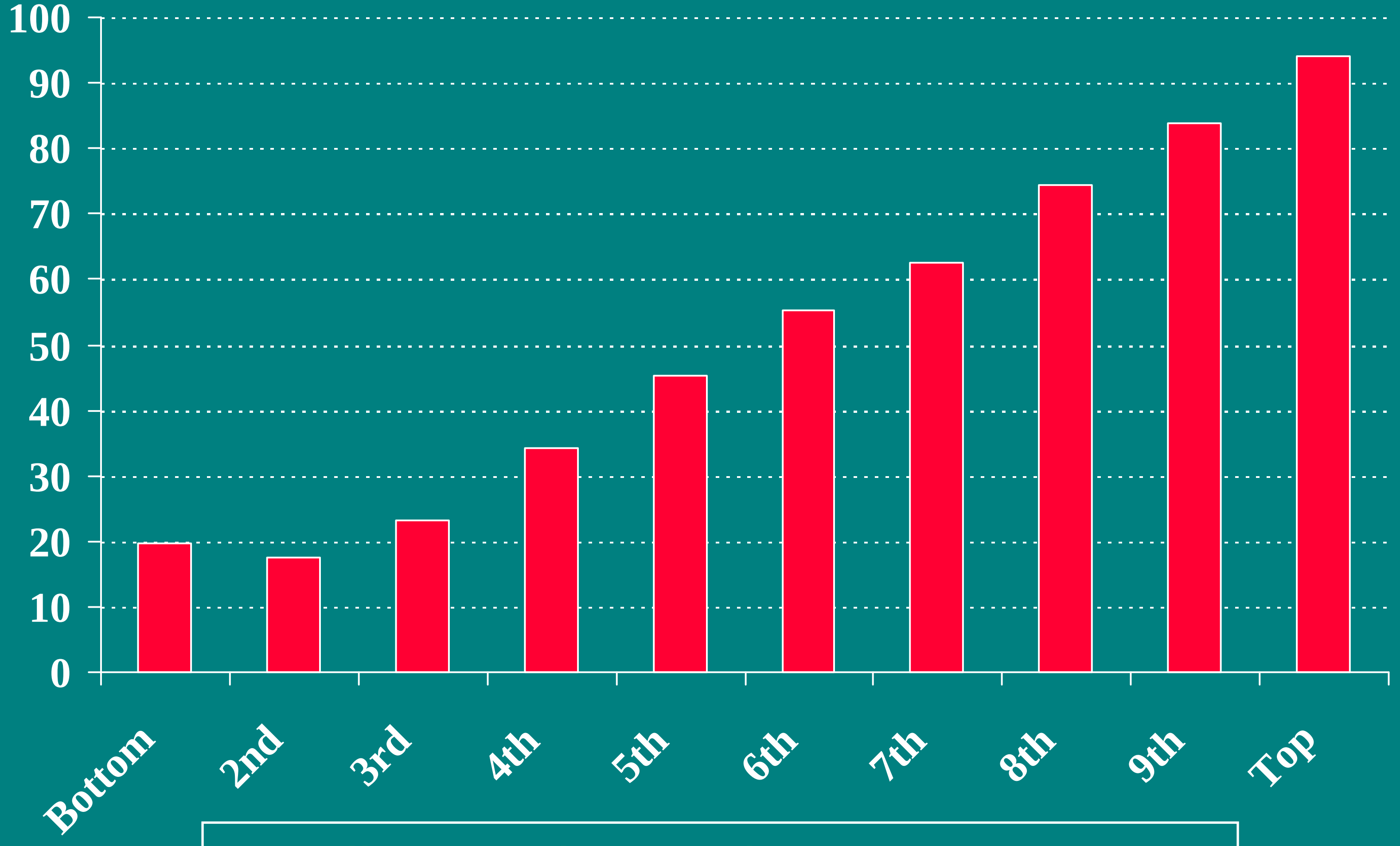
Potential impact of higher private and State pension coverage

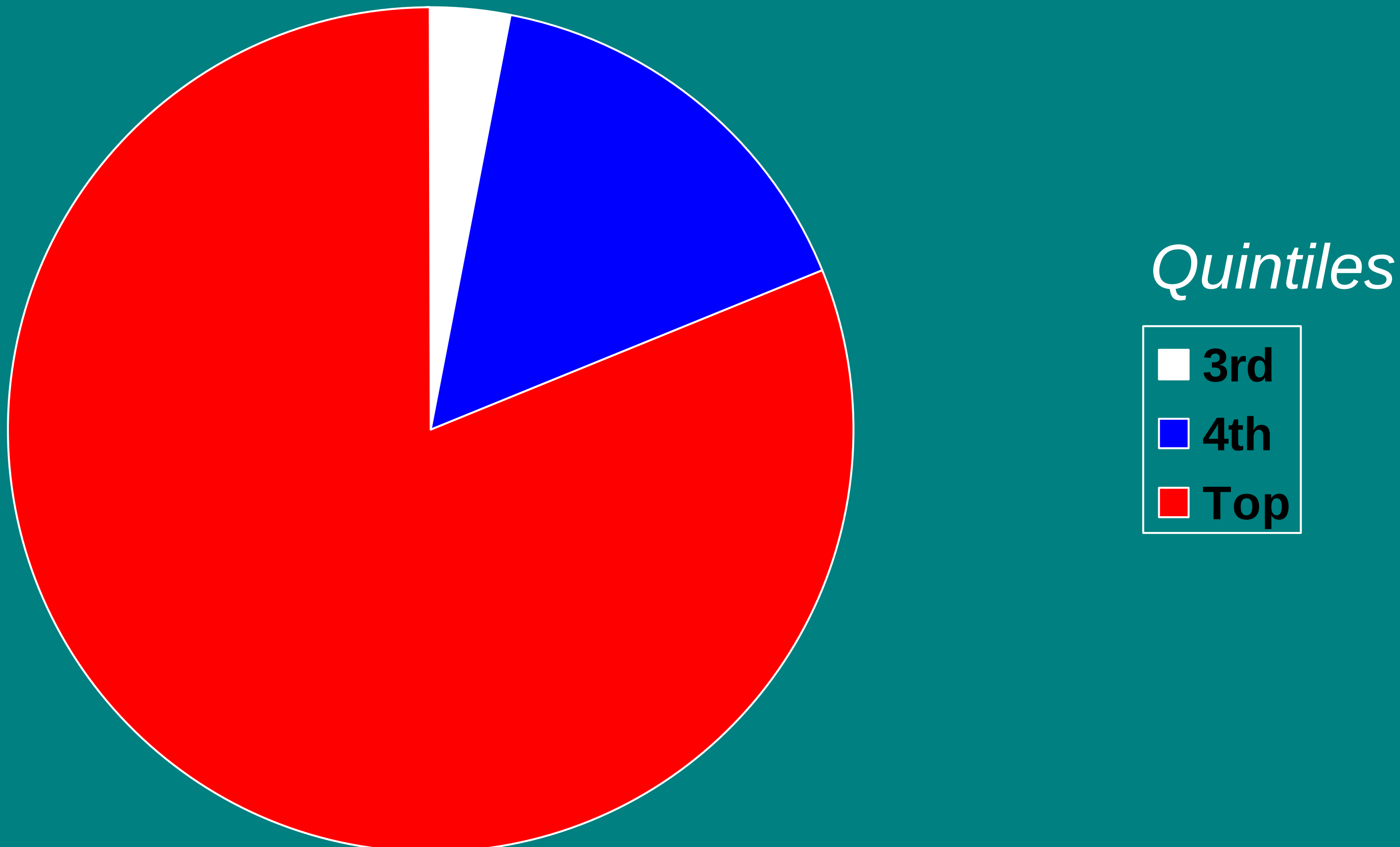
	Reduction in head count	*Reduction in poverty gap*
Higher private coverage	*33%*	*35%*
Higher State Pension coverage	*22%*	*43%*

Pension coverage by earnings level



"Deciles" each contain 10% of earners, ranked from lowest to highest incomes

Impact of standardisation of tax relief on pension contributions by income level



Why is the benefit of tax relief so concentrated on high earners?

- *High earners more likely to be covered by pension scheme*
- *More likely to make higher contributions (employer/employee)*
- *Value of tax relief is greatest if paying the top rate of tax – high earners*

Pitfalls

- *Restrictions on relief for EMPLOYEE contributions unlikely to be effective unless same applies to EMPLOYER contributions*
- *Restrictions on relief affecting funded schemes in private sector would be inequitable unless accompanied by similar measures for unfunded schemes in public sector*

Public service pension levy (PRD)

- *Wage cut, tax or pension contribution?*
- *Shift from employer to employee pension contribution*
- *For employees, like a wage cut*
- *But not same as a wage cut for current or future pensioners*
  - *Current and future pensions still based on the same gross wage*

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Policy options

- *Standardisation of relief at standard rate*
  - *Reduces relief for top rate taxpayers*
  - *Potential revenue over €1,000m*
  - *Could help to sustain State pension levels as demographic pressures intensify*
- *Standardisation at hybrid rate (e.g. 30%)*
  - *Gains for standard rate taxpayers, losses for top rate taxpayers*
  - *Exchequer gain approx. €500m*

Lessons from behavioural economics

- *Power of the default option ("soft mandatory")*
  - *automatic enrolment, with an "opt out" clause leads to more saving*
- *Visibility/transparency*
  - *Partial matching of funds saved rather than tax relief found to boost saving (cf. SSIA structure)*

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Full document now available at

www.esri.ie