Statement to the Joint Committee on Social Protection, Community and Rural Development, and the Islands, February 8th 2023

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Many thanks to the committee for inviting Dr. Keane and I to discuss automatic enrolment. We are both economists at the Economic and Social Research Institute who primarily work on tax, welfare and pensions policy.

The introduction of an automatic enrolment pension scheme has been long mooted as a response to low levels of private pension coverage, particularly outside of the public sector. The reason for this is that automatic enrolment is an effective way of raising private pension coverage. Evidence from countries such as the United States[1] and the UK[2] where similar schemes have been introduced suggest that private pension coverage can be substantially increased by simply defaulting individuals into plans, with the long-run rise in pension provision largest for those who would otherwise have saved least. We focus our comments on three features of the draft heads and general scheme that we think are worth particular consideration by the Committee during this period of pre-legislative scrutiny.

The first of these is the proposed change to the tax treatment of contributions made through an automatic enrolment scheme. Instead of applying the existing 'exempt-exempt-taxed' (EET) regime – whereby income is exempt from tax when first received and paid into a pension; exempt from tax as the returns accrue; and taxed when funds are withdrawn from the pension – it is proposed that the state will pay €1 for every €3 saved by an individual in a

[1] Choi, J.J., Laibson, D., Madrian, B.C. and Metrick, A., 2004. For better or for worse: Default effects and 401 (k) savings behavior. In Perspectives on the Economics of Aging (pp. 81-126). University of Chicago Press.

[2] Cribb, J., Emmerson, C. What happens to workplace pension saving when employers are obliged to enrol employees automatically?. Int Tax Public Finance 27, 664–693 (2020).

private pension. This amounts to a move away from the provision of marginal rate relief and towards what is in effect a flat 25% rate of relief. The general scheme justifies this on the basis that "the benefits of tax relief [are] not at all well understood by ordinary workers" with "a different approach … needed to incentivise" lower-to-middle income workers who do not currently have a private pension.[3] However, the evidence from other countries suggests no change in the structure of tax relief on pensions is required for automatic enrolment to achieve its aim as the policy works by shifting the default behaviour of individuals and firms. Given this, it is unclear that such radical reform – which would add substantially to the complexity of Ireland's pension tax regime – is needed to support the initial rollout of automatic enrolment. Instead, if after the initial rollout of automatic enrolment certain groups are still thought not to be saving adequately for their retirement, the government could then look at targeted incentives to further raise savings rates among these groups.[4]

As well as adding complexity to what is an already quite a complex system, the creation of a different, parallel system of tax relief for automatic enrolment pension schemes raises questions of horizontal equity. This is as two individuals with the same earnings profile over their lifetime will receive different levels of support from the State depending on whether their employer operates an autoenrollment or a more traditional private pension scheme. There are also more practical questions as to the portability of funds accumulated through an autoenrollment scheme to a more traditional private pension should an individual change employer, as is likely over the course of a working life.[5]

A second important feature of the draft general scheme is the facility for people who are auto-enrolled to opt-out after an initial 6-month period. Research led by my colleague Dr. Keane has examined whether such a period of compulsion may lead to issues of affordability by simulating the distributional and poverty impacts of the scheme in these initial 6 months.[6]

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[3] See p.20 of Draft Heads and General Scheme of the Automatic Enrolment Retirement Savings System Bill 2022.

[4] One such targeted incentive that could be seen as a pension variant of the SSIA scheme was suggested in an ESRI submission to the Interdepartmental Pensions Reform and Taxation Group, available at https://assets.gov.ie/96450/b92f50f7-9154-4b0c-bf73-0f39f1b3c290.pdf.

[5] Heads 63 and 66 of the Draft Heads suggests this is something that the Central Processing Authority might be directed to review at some point in the future.

[6] Keane, C., O'Malley, S & Tuda, D. *The Distributional Impact of Pension Auto-enrolment*, ESRI Working Paper No. 707.

This found that the largest impact on incomes will be felt by those around the middle of the income distribution, while the bottom two income quintiles will see the smallest fall in disposable income. These results are driven by two factors. Firstly, only 1% of those in the lowest income quintile and 7% in the second lowest income quintile will be affected by auto-enrolment due to lower employment rates and incomes in these quintiles. Second, while we know that lower earners are more likely to be autoenrolled, these individuals are often higher up the distribution of household income due to the presence of a working partner. We therefore see little impact of the scheme on the at-risk-of-poverty rate.

The final feature of the draft general scheme we wish to highlight is the proposed cap on changes on the funds of those participating in an auto-enrolment scheme. Paying for the management of a private pension is for many people the biggest purchase they make in life after buying a house. But unlike estate agent fees, or those associated with many less important purchases, pension management fees are not very salient and savers appear to face large switching costs.[7] There is therefore a good case for ensuring that schemes individuals are defaulted into have fees capped at the minimum level required to cover the costs, especially as automatic enrolment is specifically designed to alter the behaviour of those who do not pay much attention to their pension saving and who are therefore particularly unlikely to pay attention to the (often complex) charges. Head 65 of the draft Bill sensibly allows the Minister to set a limit on the charges made to the assets of an employee's auto-enrolment fund by regulation. The Department of Social Protection have previously suggested that this cap would be set at 0.5% per year,[8] which while lower than that applied in some other countries is higher than the 0.3% charge levied by the British National Employment Savings Trust that might serve as a useful benchmark.

We thank the Committee for their time and look forward to discussing these or other aspects of automatic enrolment.

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[7] Hastings, H. and Syverson, 2017. "Sales Force and Competition in Financial Product Markets: The Case of Mexico's Social Security Privatization". Econometrica, Vol. 85, No. 6, 1723–1761.

[8] See Final Design Principles of an Automatic Enrolment (AE) Retirement Savings System for Ireland, available at https://www.gov.ie/pdf/?file=https://assets.gov.ie/219768/4aada71d-2731-4522-b218-9184a699652f.pdf.