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PENSION PRIORITIES: GETTING THE BALANCE RIGHT?*

Tim Callan, Brian Nolan and John R. Walsh

1. Introduction

The National Pensions Policy Initiative (NPPI) recommended a target replacement income of 50 per cent of pre-retirement income before tax, and an overriding minimum income of 34 per cent of gross average industrial earnings (GAIE). The Pensions Board (2005), in its National Pensions Review, confirmed these targets.¹ However, a number of Board members

...believe that a higher minimum pension target is needed to ensure that pensioners without supplementary pensions have an adequate income by reference to household incomes generally. Other board members also support an increase in the basic pension target for reasons of greater social equity.

Here we revisit these issues, and are able to analyse the trade-off between the costs of State pensions, the cost of State support for private pensions and the overall impact on poverty and the distribution of income.

Our perspective includes both the minimum income guarantees through the State's old age pension and pensions provided by employers (including the State and public authorities as employers). We also take account of privately organised pensions unrelated to the State or to employers. We begin (Section 2) by reviewing evidence on the risks of poverty faced by older people. As well as Irish evidence, we draw on a recent review of EU experience, which points to links between differences in pension systems and differences in poverty risk. Section 3 then examines more closely the impact of changes in State pension payment rates between 2000, when 'at risk of poverty' rates for older people were very high, and 2006, by which time poverty risks for older people were much lower,

* We are grateful to the referees for their comments.

¹ The report notes that the representative of the Department of Finance did not agree to this target.

and close to the average. In this section we use the *SWITCH* tax-benefit model to isolate that part of the reduction in poverty risk due to the changes in payment rates.

Turning to potential future policy developments, Section 4 looks at options related to the income tax treatment of pension contributions. At present, all contributions – whether by an employer, the individual himself or herself, the State as employer, or made to a private pension plan – are allowable against income tax.² We estimate the total size and distributional impact of this tax expenditure. We then consider an illustrative package involving a “standardisation” of the tax relief on pensions – as was done with mortgage interest relief and relief on health insurance premia. This would generate a rise in income tax revenue which could be used in many ways. For simplicity, we examine first of all a flat rate increase in social welfare pensions (including all of the rates for those over 66 years outside the main pension schemes). We then estimate the net cost and distributive effect of the package, and its likely “first round” impact on the ‘at risk of poverty’ measure. The final section draws together the main findings.

2. Poverty Risks Among Older People

2.1 POVERTY RISKS AMONG OLDER PEOPLE: TRENDS, LEVELS AND ALTERNATIVE MEASURES IN IRELAND

Measuring poverty gives rise to a range of conceptual and empirical issues which we cannot address here (though we have done so extensively in previous work). Instead, we focus on a key indicator in the EU’s Social Inclusion Process, the ‘at risk of poverty’ rate, and how it has been changing for older people in Ireland. This counts as ‘at risk of poverty’ persons living in households falling below a specified percentage of median income in the country in question, with the most commonly-used threshold being 60 per cent of the median. Table 1 shows how this ‘at risk of poverty’ measure has evolved over the past 10 years in the Irish case, for older people and for all ages, drawing on results from the *Living in Ireland Survey* (1994 up to 2001) and in more recent years, the *EU Survey on Income and Living Conditions* (*EU SILC*).

‘At risk of poverty’ rates were high for older people in the 1980s, but fell to 6 per cent by 1994 – well below the corresponding risk for all persons. This risk for older people rose sharply in the following years, rising to almost one in four by 1997, and to 44 per cent by 2001. By this time the risk was more than double that for all persons. It is not clear how much of the decline from 44 per cent (*Living in Ireland, 2001*) to 30 per cent (*EU SILC, 2003*) is due to the difference in income definitions between the surveys (see note to table for details). But more recent figures from the CSO’s *EU Survey on Income and Living Conditions* (*EU SILC*) indicate that ‘at risk of poverty’ rates for older people declined from just under 30 per cent to about 20

² The amount allowed is subject to limits in relation to income.

per cent between 2003 and 2005. This decline means that risk of income poverty for the elderly is now only marginally greater than the overall risk for all persons. However, as child poverty remains higher, the 'at risk of poverty' rate for older people is higher than the risk for working-age adults.

Table 1: 'At Risk of Poverty' Measure for Older People and for All Persons, Ireland, Selected Years, 1994-2005

	Data Source	Percentage of Older People 'at Risk of Poverty'	Percentage of All Persons 'at Risk of Poverty'
1994	LII	5.9	15.6
1997	LII	24.2	18.2
2000	LII	38.4	20.9
2001	LII	44.1	21.9
2003	CSO EU SILC	29.8	19.7
2004	CSO EU SILC	27.1	19.4
2005	CSO EU SILC	20.1	18.5

Note: While the income definitions in the two data sources (the *Living in Ireland Survey* up to 2001 and the *EU SILC* from 2003 onwards) are very similar, there is a difference which particularly affects older people. Non-cash benefits such as free electricity, gas and a TV licence are not included as part of disposable income in the *Living in Ireland Survey*, but are included with cash incomes in the *EU SILC* measure of disposable income.

It is clear from the foregoing that 'at risk of poverty' rate for older people is quite volatile. The volatility of the risk relates in part to the fact that many older people are heavily dependent on the State pensions, contributory and non-contributory. If these payment rates are close to the poverty threshold, then a small change either way (or a small additional income) can move many people above or below the threshold.

Income is a key resource, but not the only element of "command over resources" that affects individuals' and families' standard of living. Nolan and Whelan (1996), argued for the use of a combination of information on income with key indicators of basic deprivation (being unable to afford basic items or activities) to identify those living in what was termed "consistent poverty". This is the approach which has been adopted by the National Action Plan for Social Inclusion. Table 2 draws together published evidence on the rate of consistent poverty for older people, and for all persons.³

³ The situation of older people in Ireland in terms of other measures of economic vulnerability has also been analysed in a number of recent studies by the ESRI, including the *Social Portrait of Older People* prepared for the Office for Social Inclusion (Fahey, Maître, Nolan and Whelan, 2007).

Table 2: Proportions of Older People and of all Persons in Consistent Poverty, Selected Years, 1997-2005

	Older People		All Persons	
	At 60 Per Cent Median Income	At 70 Per Cent Median Income	At 60 Per Cent Median Income	At 70 Per Cent Median Income
1997		8.4	7.8	10.7
1998			6.0	7.7
2000			4.3	5.4
2001		3.9	4.1	4.9
2003	5.8		8.8	
2004	3.3		6.8	
2005	3.7		7.0	

Sources: 1997-2001: Whelan *et al.* (2003).

2003-2005: CSO Statistical Releases on *EU SILC*.

Two key points emerge clearly from this table. First, the rate of consistent poverty for older people is always below the rate of consistent poverty for all persons. This contrasts with the risk of income poverty measure, where older people were sometimes at much lower risk than others, and sometimes at much greater risk. Second, the rate of consistent poverty for the elderly is very far below the ‘at risk of poverty’ measure. e.g., for 2003 the ‘at risk of poverty’ rate was close to 30 per cent (at the 60 per cent of median income cut-off) while the corresponding rate of consistent poverty was under 6 per cent.

What gives rise to these quite different results for the ‘at risk of poverty’ rate and consistent poverty? The major factors relate to the non-income resources available to support the standard of living of the elderly. These include the fact that most older people own their own homes outright, without any mortgage. As a result, their housing costs are very low, and their cash incomes can stretch further in purchasing their other needs. The standard economic approach to take this into account is to move to a broader measure of income which includes the value of the “in-kind” benefit enjoyed by the home owner from his or her own property. Different valuation methods have been proposed, but the simplest way of thinking about this is that rather than the owner paying zero rent and having zero income from the property, he or she rents it to himself/herself. This “imputed rent” is added to the home-owners’ income to put the resources of the home owner on a similar footing to a tenant. Tenants may also benefit from an imputed rent, if they enjoy the use of a property at less than the market rent. These issues, including different valuation methods for imputed rent, and the implications for measurement of income distribution and poverty,

are currently being examined in a project involving 8 European countries.⁴

Zaidi *et al.* (2006a) also point to the financial assets and wealth of older people as important considerations in determining their overall command over resources. For example, assets built up over earlier stages of the lifecycle may be used to provide resources additional to income. Given suitable data on financial assets one could calculate an annuity equivalent and add it to income as one way of taking this into account.⁵ One group whose command over resources might be substantially affected by this is older farmers, for whom the annuity equivalent of the farm as an asset may be well in excess of the income generated as a farm enterprise. However, the data required to implement this approach are not available at present for Ireland. Family support may also allow an older person to maintain a standard of living higher than their income alone would allow.

2.2 INCOME POVERTY RISKS AMONG OLDER PEOPLE: IRELAND IN EU CONTEXT

Before looking at possible reforms to the Irish pension system, it is worth looking at its effectiveness in comparative perspective. Such a comparison can be based on data produced by Eurostat for the EU's Social Inclusion Process, but there are a number of caveats relating to the figures for Ireland which are discussed in detail in the Appendix to this paper. For that reason we concentrate here on the main messages to be drawn from the comparison of Ireland with our EU partners rather than on presenting precise figures. (The underlying problem is that different institutional structures for pensions make standardisation of the concepts and data problematic.)

Focusing first on 'at risk of poverty' rates for older people, Zaidi *et al.* (2006a) use the data produced by Eurostat to divide EU countries into low, medium and high poverty risk groups. The high poverty risk group includes Ireland and the UK, along with Spain, Greece and Portugal – and while the precise figure for Ireland may not be robust this grouping still seems reasonable. The low poverty risk group includes several accession states, as well as the Netherlands, France and Luxembourg. The Dutch system has the lowest poverty risk of the three. Zaidi *et al.*, point to the fact that the Netherlands has a universal, residence-based basic pension, indexed in line with wages, along with mandatory occupational pensions and generous survivors' benefits in occupational pensions.

Looking then at the effectiveness of pensions in reducing poverty risk, analysis conducted in the EU *Joint Report on Social Inclusion* suggests that the reduction in the risk of poverty achieved by the public pension system is relatively low in Ireland. By contrast, Ireland's poverty reduction from other social transfers (affecting the

⁴ The project is part of a broader one on Accurate Income Measurement for the Assessment of Policy (AIMAP).

⁵ This approach was pioneered by Wolff (1990) for the US.

non-elderly) is closer to the average for EU15. This suggests that differences in pension systems had a key role to play in explaining the gap between the reduction in poverty achieved in several major EU countries and that achieved in Ireland.

3. State Pensions: Exploring the Impact of Recent Policy Changes

Evidence from the CSO analysis of *EU SILC* surveys points to a sharp reduction in the proportion of older people ‘at risk of poverty’. In 2003, the risk for older people was close to 30 per cent – about one and a half times the risk for all persons. By 2005 the risk had fallen to just over 20 per cent, not much more than the risk for all persons (though higher than the risk for other adults). Comparison of the risk figures with earlier years is complicated by a difference in the treatment of non-cash benefits such as free electricity etc.

Here we try to identify how much of the reduction is due to changes in the rates of payment for the main State pension rates (Old Age Contributory and Non-Contributory Pensions) along with rates paid to those on other schemes who are of pension age. We analyse this question by comparing the actual 2006 policy with a counterfactual policy, under which these pension rates would be indexed in line with wage growth from their 2000 levels, while all other policy parameters would remain at their actual 2006 levels. This isolates the impact of 2006 actual policy over and above a “neutral” policy, simply indexed in line with wages. (For a detailed rationale of this “distributionally neutral” policy, see Callan *et al.*, 2005.)

The total cost of the actual 2006 pension rates, over and above the 2000 rates indexed in line with wage growth of 42 per cent, is estimated at €515 million. Table 3 shows how this amount is distributed over the deciles of equivalised income, and the proportionate gain in income for each decile.

Table 3: Impact of Changes in State Pension Rates, Over and Above Wage Indexation, 2000-2006

Decile	Aggregate Gain in €m Per	
	Annum	Percentage Gain
Bottom	89	5.7
2 nd	67	3.6
3 rd	180	6.1
4 th	102	2.1
5 th	25	0.4
6 th	20	0.3
7 th	11	0.1
8 th	7	0.1
9 th	5	0.1
Top	8	0.0
All	515	0.8

The gains are strongly concentrated on the bottom four deciles of the income distribution. This group obtains 85 per cent of the total

benefit from the package of policy changes implemented between 2000 and 2006. Income in these deciles rises by between 2 and 6 per cent, as against an overall figure of 0.8 per cent.

Despite this strong concentration towards the bottom of the income distribution, the head count measure of the risk of poverty for older people declines by no more than 5 percentage points (from a base of about 40 per cent). However, there is a substantial reduction in the “poverty gap” measure which takes into account both the incidence of poverty – as measured by the head count – and the depth of poverty, how far those in poverty are below the income poverty line. This “poverty gap per person” measure falls by 45 per cent.

Table 4: Impact of Changes in State Pension Rates, Over and Above Wage Indexation, on ‘Risk of Poverty’ and Poverty Gap for Older People 2000-2006

Poverty Risk Without Changes	Poverty Risk with Changes	Reduction in Poverty Risk	Percentage Reduction in Poverty Gap
40	35	5	45

Such findings are not unusual, and reflect a key weakness in the commonly used “head count” measure of poverty. A policy may improve the lot of many poor persons, without raising any of them above the poverty threshold. In such circumstances, the head count measure will show no change in poverty, but the poverty gap measure will show a reduction depending on the extent to which the policy has brought people closer to the poverty threshold income. On the other hand, a policy which left the aggregate income of those initially in poverty unchanged, but transferred income from those who were poorest to those close to the poverty line income could result in a substantial fall in the head count. The lesson to be drawn from this is that we must look at both head count and poverty gap measures in order to obtain a fuller picture of the impact of policy changes (or of economic and social developments) on poverty risks.⁶

⁶ It should be noted that there are two types of poverty gap measure. One, due to Foster, Greer and Thorbecke (1984) combines information on the extent of poverty (as measured by the head count) and the depth of poverty (how far below the poverty line each poor person falls). An alternative measure is used in recent EU social inclusion analyses. It looks at the poverty gap (as a proportion of the poverty threshold) for the median poor person i.e., halfway between the poorest person and the poor person whose income is closest to the poverty line. There are advantages and disadvantages to each measure, but in either case, it is necessary to consider both the head count measure and the poverty gap measure to obtain a full picture. Here we use the poverty gap measure developed by Foster, Greer and Thorbecke.

4. Tax Expenditures on Private Pensions

The current tax treatment of occupational pension contributions is that both employer and employee contributions are deducted when calculating income for tax purposes. Alternatively, this can be viewed as a tax-free allowance equal to the value of the employee and employer contributions, allowable at the individual's marginal rate of tax, be it standard rate or top rate. Payments by the self employed in respect of retirement annuity premia are also treated in the same way. These tax reliefs on pension contributions can also be regarded as "tax expenditures".

The "tax expenditure" approach highlights the fact that the tax system is sometimes used to achieve goals which are similar to those of the public expenditure system. Identifying the cost of the tax reliefs, and their distribution across persons, is then an important element in assessing whether the policy approach is an efficient and effective way of achieving these goals.

Tax expenditures are identified with reference to a benchmark tax system, including definitions of the tax base and the rate structure. As Whitehouse (1999) notes, there are variations in international practice in the identification of tax expenditures regarding pensions.

In Australia, Canada, Spain and the United States, the comprehensive income tax – with pension benefits tax-free and contributions and investment returns taxed – is used as the benchmark....In the United Kingdom, the actual tax treatment is compared with a so-called 'unapproved' scheme, where contributions and investment returns are taxed but the withdrawal of the pension as a lump-sum is tax-free. This is equivalent to the comprehensive income tax treatment (i.e., TTE). Other countries (such as the Netherlands) do not report tax expenditures for pensions at all or (for example, Germany) choose a benchmark very much closer to the actual treatment. Whitehouse (1999, p. 29).

There is also substantial variation across countries in the actual tax regime applied to pensions, as documented by Whitehouse. The classic theoretical treatments of pension contributions, pension fund income, and pension payments to beneficiaries include (using the notation T for Taxed, E for exempt):

EET: Pension contributions and pension fund income are exempt, and pension payments are taxed in the hands of the beneficiary. This corresponds to the expenditure tax treatment.

TEE: This also relates closely to expenditure tax treatment, and is sometimes termed the "prepaid" expenditure tax treatment.

One feature of interest in the present context is that countries use different forms of limitation on the amount by which tax liability can be reduced through increasing pension contributions. Whitehouse (1999) identifies the following possibilities:

- absolute limits on the amount of contributions (e.g., Australia, Germany);
- limits on the proportion of contributions that can be deducted (e.g., Austria, Finland);

- limits on the proportion of income on which contributions can be made (e.g., Ireland and the UK).

In this paper we investigate another type of limitation, which limits the deductability of contributions at higher rates of income tax. Like many of the actual systems examined by Whitehouse, this diverges from the classic theoretical treatments, but analysis of this case is of some independent interest, given the political economy of standardising tax reliefs. Investigation of a full TEE regime is a topic of interest for further research.

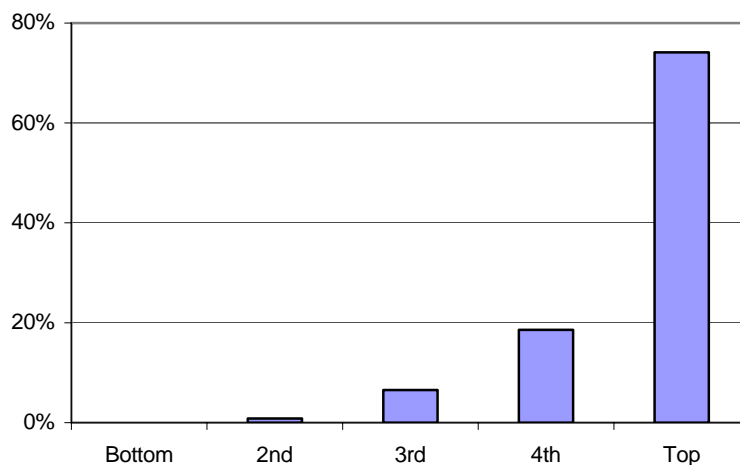
Whitehouse goes on to show that restricting the deductability of contributions is close to introducing a comprehensive income tax, whereas the current treatment in Ireland and in the UK is close to that of an expenditure tax. If the overall tax system were to move towards an expenditure tax base rather than an income tax one, the existing tax arrangements for pensions would involve little or no redistribution. Arguments for and against the differing treatments of pension contributions need to be considered in this wider context, but the likelihood of such a fundamental shift – debated here some years ago when the Commission on Taxation reported – seems slight. A prerequisite for an informed debate on this topic is a sense of the scale of the tax reliefs, and the distribution of the benefits which arise from them. It is to this issue that we now turn.

Hughes and Sinfield (2004) show that similar tax arrangements in the UK and the US, designed to encourage the growth of private pension schemes, lead to a concentration of tax relief among the highest income groups. This is for two reasons.⁷ The first is that the rate of membership of occupational pension schemes (and contributions by the self-employed) rise strongly with income. The second is that tax relief is allowed at the top marginal rate. Hughes (2005) shows that tax relief is also highly concentrated towards the top of the Irish income distribution.

This is confirmed by analysis using the *SWITCH* model. It differs from Hughes (2005) in two respects. First it is based on family units rather than households – though the results are similar in either case. Second, whereas Hughes looks at quintiles of employees and self-employed separately, we use family income per adult equivalent, over the full income distribution, as the ranking criterion for division into quintile groups. The results are shown in Figure 1, and are broadly similar to those of Hughes. If anything, the contributions are concentrated somewhat more in the top quintile. Hughes (2005) found that the tax relief from retirement annuity premia paid by the self-employed were more strongly concentrated towards the top of the self-employed income distribution than the relief from employee contributions.

⁷ Agulnik and Le Grand (1998) and Hughes (2005).

Figure 1: Distribution of Benefit from Exemption of Employee Superannuation Contributions by Quintile of Family Units



Source: SWITCH model.

It could be argued that the current income of the household is not the most relevant point of reference in thinking about the distributional implications of different approaches, and that some currently middle- or high-income households benefiting from the arrangements will be on much lower incomes when they retire. It would be very useful to complement the present analysis with a lifetime income perspective, and studies for some other countries have sought to do so. However, the evidence still suggests that, as Sinfield (1997) puts it (in relation to broadly similar arrangements in the UK): *The greatest beneficiaries are those who have the least needs by any measure used in social policy analysis.* It is of interest then to establish more closely the extent of the support being provided through this mechanism, and examine possible reallocations of resources which might better serve the overall objectives of social policy and pensions policy. Similar arguments have been accepted and acted upon in the case of mortgage interest tax relief, which is now allowed at the standard rate of tax, not at the top marginal rate.

In order to provide a benchmark for the extent of the resources implied by the tax treatment of pension contributions, we have attempted to estimate the cost of tax reliefs in respect of employee contributions, employer contributions and self-employed contributions. One issue which arises in this context is the correct treatment of the State's own public service superannuation scheme. This is a "pay as you go" scheme so there are no contributions to the core scheme, and benefits are paid out as they become due. In the present context, where both employer and employee superannuation contributions are exempt from tax, there are no particular tax issues associated with the accrual of pension benefits under the civil/public service superannuation scheme. If employee and employer

contributions were to become – to any extent – taxable, then an inequity would arise if the State scheme were to maintain a tax-free status because it is not explicitly funded. Thus, in principle, a similar approach would be required for the State superannuation scheme. The accrual of pension benefits, while not recorded in pay, would amount to a “benefit-in-kind” that would have to be valued and taxed in the same way as contributions to a fund. Otherwise a sharp inequity would arise between public and private sector employees. There are of course many issues which would arise from such a change, including implications for wage bargaining in the public and private sectors, and the detail of how it would be administered and implemented. Here we abstract from these issues to get a broad view of the overall impact of a shift in the tax treatment in pensions. It is worth noting, however, that if, tax relief were restricted to the standard rate, then only those on the top rate of tax would be affected by the change.

The estimates of pension contributions were constructed as follows:

- Employee contributions were derived from information provided by employees on deductions from pay. Employee membership of an occupational pension scheme was measured using questions from the *Living in Ireland Survey*, as used in studies of the coverage of pensions.
- Typically employee contributions were of the order of 5 per cent, and employer contributions at 10 per cent. But as this split could differ, and we had direct information on employee contributions only, employer contributions were constructed as the balance between the employee contribution and 15 per cent. This assumption involves the same total contribution rate for all schemes. If, as is likely, contribution rates are higher for higher paid workers – as a tax efficient method of compensation – then the estimates derived here would understate the share of top earners in the tax relief.
- For the self-employed, information directly provided by respondents was used.
- For public sector employees, it was assumed that the government’s contribution was sufficient to bring the total contribution to 20 per cent of pay, given that the public service pension scheme offers higher income guarantees (including parity with those in employment in the same grade).

This combination of data and “stylised facts” about pension systems allows a more comprehensive picture of the pension contribution/financing situation than has been possible heretofore.

Table 5 provides new estimates of the income tax foregone by the tax treatment of pensions. These are compared with estimates by the Revenue for 2000.

Table 5: Estimates of Tax Foregone on Pension Contributions, *SWITCH* and Revenue Commissioners

Component	<i>SWITCH</i> Estimate of Tax Foregone 2000 €m Per Annum	Revenue Estimate of Tax Foregone, 2000/01 €m Per Annum	<i>SWITCH</i> as Percentage of Revenue Estimate %	<i>SWITCH</i> Estimated Aggregate Contributions €m Per Annum	Average Tax Rate Implied by <i>SWITCH</i> Analysis %
Employee contributions	255	472	54	820	31
Self-employed/ retirement annuity premia	111	205	54	362	31
Employer contributions	922	646	143	2,321	40
Government as employer, contribution equivalent	706	n.a.	n.a.	1751	40
Total, excluding government	1,288	1,323	97	3,503	37

For both employees and the self-employed, the *SWITCH* estimate of tax foregone is 54 per cent of the corresponding Revenue estimate. For employer contributions, however, the *SWITCH* estimate is more than 40 per cent higher than the Revenue estimate. Given that the employer contributions are estimated as a residual from the average total rates of contribution, this may arise if employees in reporting their incomes understate or neglect to state the amount of their own contribution. In this case the estimate may be close to the total contribution, though the split between employer and employee is inaccurate. Thus, the ratio between the *SWITCH* estimate of the cost of tax relief for employer, employee and self-employed contributions is very similar to the Revenue estimate. It should be noted, however, that the *SWITCH* estimate is derived by attributing the benefit of employer contributions to the relevant individuals, so that the tax relief is at the relevant personal rate of tax. The Revenue estimates, on the other hand, may value the tax relief of employer contributions made by companies at the relevant, and much lower, corporate income tax rate.

When this is taken into account, it seems likely that the *SWITCH* estimates of the value of tax foregone are lower than might be expected. One factor contributing to this is that, in general, household survey data do not obtain good coverage of the very highest echelons of the income distribution – a group which tends to have very large pension contributions. Another, mentioned earlier, is the assumption that total contribution rates are constant across income groups, when tax efficiency suggests that contribution rates are likely to rise with income.

Some further evidence on the internal consistency of the estimates is provided by the implicit tax rate (the value of the tax relief divided by the total amount of contributions in the relevant category). For employees this is 31 per cent, at a time when the standard tax rate was 22 per cent, and the top tax rate 44 per cent.

As higher rate taxpayers are known to be more likely to contribute to pension schemes, and more likely to contribute greater amounts, this is not implausible. The implicit tax rates for employer contributions and imputed government contributions seem rather closer to the top tax rate than one might expect. On the other hand, the implicit tax rate for the self-employed is no higher than that for employees, when a higher figure might have been expected. These results suggest that further work is required in calibrating the estimates of contributions, but it is nonetheless of interest to use these initial estimates as a basis for an exploration of policy issues.

The inequity of having higher rates of support for the pensions of high-earners (top rate taxpayers) is recognised in the *National Pensions Review* (Pensions Board, 2005).⁸ The approach suggested there is one of “levelling up” support so that all those paying contributions to private pensions would enjoy relief at the top tax rate. But this involves extra resources for those who can afford to pay for private pensions (and still involves greater amounts for those with top incomes). An alternative is to allow the relief at a single lower rate than 40 per cent. Here, for simplicity, we examine policies involving standardisation at the standard tax rate of 20 per cent, as has been implemented for mortgage interest tax relief and health insurance premia. We look at the impact of doing this and channelling some of the resources gained by the Exchequer into an increase of €50 per week in the State pension.

Table 6: Standardisation of Pension Tax Relief and €50 Rise in State Pensions

Decile	Aggregate Gain/loss in €m Per Annum	Percentage Gain
Bottom	4	0.3
2 nd	88	3.5
3 rd	430	14.3
4 th	267	5.2
5 th	48	0.8
6 th	-12	-0.2
7 th	-94	-1.2
8 th	-183	-2.1
9 th	-403	-3.8
Top	-770	-4.3
All	-626	-0.9

Table 6 shows that the net gains from this package are concentrated in the third and fourth deciles. The greatest proportionate gain is also for the third decile. This reflects the

⁸ It should be noted, however, that the structure of the social insurance system, with pay-related contributions and flat rate benefits, is an offsetting influence. A closer study of the redistributive impact of the social insurance system, taking into account life cycle elements, would be of considerable interest.

improvements in the relative income position of pensioners in recent years. On balance, there are losses for all deciles in the top half of the income distribution.

It should be noted, however, that this reform is not revenue-neutral. It generates over €600 million per annum of extra net revenue for the Exchequer. These resources could be used to redesign the package in various ways. For example, instead of full standardisation, part of the pension contributions could be allowed against the top rate of tax, thus moderating the income losses for top-rate taxpayers associated with the package. That is, of course, on the assumption that additional resources on this scale are indeed generated by this change in tax treatment of pensions. The sums shown are the product of an arithmetic calculation assuming a change in tax treatment and no change in the size of the flows involved. It is likely that behaviour would in fact change, with some of the resources previously channelled into private pensions being redirected towards other tax-favoured forms of saving. It is extremely difficult to judge how great this response might be – and it could be taken into account in adjusting tax treatment of other types of saving if necessary – but it would have to be factored in to an assessment of the overall budgetary impact. (The potential sensitivity to changes in tax treatment provides one rationale for moving to standard-rating the relief rather than abolishing it entirely.)

What of the impact on poverty? We look first at the impact on the risks of income poverty for older people, and then at the implications for overall poverty risk. Table 7 shows the effect on the head count and “poverty gap per person” measures at both the 50 per cent and 60 per cent of median income cut-offs. (It should be remembered that the initial poverty risks are the result of a simulation of the year 2006, based on uprated 2000 data – these are not intended as precise estimates of poverty rates in 2006, but

Table 7: Risks of Income Poverty: Headcount and Poverty Gap at 50 Per Cent and 60 Per Cent of Median Income: Baseline Estimates (2006) and Pension Reform Package

	Baseline	Pension Reform Package	Percentage Change in Measure
‘At Risk of Poverty’ Headcount	%	%	%
50 per cent of median income	8.2	1.3	84
60 per cent of median income	40.5	3.1	92
Poverty Gap			
50 per cent of median income	0.7	0.4	43
60 per cent of median income	5.0	0.7	86

incorporate many key features of the 2006 situation. Our interest, however, is in changes in poverty risk due to policy changes, and here the simulations have an advantage over actual data in being able to “hold constant” all things other than policy.)

The pension reform package involving standardisation of income tax relief and a higher State pension leads to the virtual elimination of the risk of income poverty at both the 50 per cent and 60 per cent lines. Correspondingly, the poverty gap measures also fall to very low levels.

5. Conclusions

In this paper we have examined risks of income poverty for older people in Ireland. Over time, the ‘at risk of poverty rate’ (at 60 per cent of median income) rose from low levels in 1994 to over 40 per cent around the year 2000, but has been coming down since then and is now close to the average for all persons. The Irish rate is relatively high in EU comparative perspective, while the lowest risk of poverty for older people in Western Europe was in the Netherlands, a country with a strong basic pension and mandatory occupational pensions. Older people in Ireland have lower than average consistent poverty rates – that is, when both low income and direct measures of deprivation are used – with home ownership, financial assets and family support all contributing to explaining this contrast with the picture based on income alone.

The impact of recent changes in State pension rates on the risk of poverty was identified. While the impact on the “head count” measure of poverty was limited, the changes did reduce the depth of poverty for older people substantially.

A restructuring of State supports for public and private pensions, limiting tax relief on pension contributions to the standard rate of tax, offers scope for substantial reductions in poverty for older people. On a purely arithmetic basis, standardisation could bring in to the Exchequer more than enough resources to allow the State pensions to be increased by €50 per week, which would virtually eliminate the risk of income poverty for older people. There are, of course, many issues involved in such a restructuring. Some of these are discussed in the paper, but others are left for further research, including the implications of demographic ageing, and how the flow into pension-related savings would respond, which would determine the impact on revenue for the Exchequer. However, the results indicate that further analysis of options of this type is well worthwhile.

Changes in the structure of long-standing tax reliefs often incorporate an element of “grandfathering” i.e., protecting those who have relied upon the relief by prolonging it for existing beneficiaries for some period of time. One could interpret our results on the package involving standardisation of relief and a higher State pension as pertaining to a regime announced now, and put into effect for the future. Contributions already paid would have attracted full relief, and contributions might continue to attract full relief for some specified period, or for those within a certain distance

of the standard retirement age. But gradually, new entrants or new contributions would attract relief only at the standard rate, allowing a transition from the current situation to a new regime like that outlined here.

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APPENDIX: AN EU PERSPECTIVE ON INCOME POVERTY RISKS AMONG OLDER PEOPLE

As part of the EU's Social Inclusion Process, a range of indicators are monitored to allow progress to be tracked over time, and figures on these are available in a database produced and regularly updated by Eurostat. Using these figures to put poverty among older people in Ireland in comparative perspective is complicated by the fact that there are significant differences between the income concept used by Eurostat and that used in national analyses of Irish data by the CSO (in its regular publications based on the Irish element of the *EU Survey on Income and Living Conditions*) and the ESRI (in analyses of the Irish element of *SILC* and of the earlier *Living in Ireland Survey*). The most important is the treatment of pensions which are privately organised by the individual, most often the self-employed, not forming part of a State or occupational scheme. In national Irish analyses, these are considered as part of disposable income, but in the EU-level database they are excluded. Persons relying on this income, and without sufficient income from other sources, will therefore, be deemed to be 'at risk of poverty' in EU-level analyses, whereas the national level approach may find they have sufficient income, including private pensions, to keep them above the poverty threshold. The treatment of pension contributions (public or occupational, not private) also differs in that the Eurostat database treats superannuation contributions as a deduction from gross income before arriving at disposable income; national level analysis treats superannuation contributions as part of disposable income. The origins of these differences lie in different institutional structures, which make standardisation of the measurement approach problematic.

To illustrate where Ireland stands in terms of these EU figures we can use the recent review of EU experience regarding the risk of poverty for older people by Zaidi *et al.* (2006a), which drew on the

Eurostat figures. Table A1 shows the ‘at risk of poverty’ rate and median poverty gap for those aged 65 years or over for each member state in 2002 or 2003. We see that Ireland is shown as having an ‘at risk of poverty’ rate of 41 per cent, which is much higher than most of the other countries and exceeded only by Cyprus. This is much higher than the figure of 20 per cent shown by the latest figures for Ireland produced by the CSO. The latter relates to 2005 rather than 2003, and employs a different adjustment factor in adjusting income for household size, but the different treatment of some types of pension must also play a role in producing this difference – the extent to which it is responsible is an important issue for further research.

Table A1: Proportion of Older People ‘at Risk of Poverty’ in Member States and Median Poverty Gap Among those Older People ‘at Risk of Poverty’

Country	Survey Year	‘At Risk of Poverty’ Rate (%)	Median Poverty Gap as % of Poverty Line
Czech Republic	2003	4	7
Poland	2002	7	14
Hungary	2002	8	11
Netherlands	2002	8	7
France	2002	10	10
Latvia	2002	10	8
Lithuania	2002	12	13
Luxembourg	2003	12	24
Slovakia	2003	13	15
Sweden	2002	15	11
Germany	2003	16	17
Austria	2003	16	17
Estonia	2003	17	10
Italy	2001	17	21
Finland	2003	17	11
Slovenia	2002	19	17
Malta	2000	20	17
Denmark	2003	21	9
Belgium	2003	23	17
United Kingdom	2003	25	18
Greece	2003	28	27
Spain	2003	28	22
Portugal	2001	30	22
Ireland	2003	41	14
Cyprus	2003	52	24
EU 15	2003	18.8	17
New Member States	2003	8.5	13
EU 25	2003	17.4	16

Note: Countries ranked by ‘at risk of poverty’ rate, lowest to highest and divided into “low”, “medium” and “high” poverty risk groups by Zaidi *et al.*

Source: Zaidi *et al.* (2006a), Tables 1 and 5. Details of sources are given by Zaidi *et al.* in Box 1. For Ireland, the source is *EU SILC 2003*, from the Eurostat website at <http://epp.eurostat.cec.eu.int>

