

SYMPOSIUM ON PENSIONS: IMPLICATIONS FOR PUBLIC POLICY

JIMMY JOYCE
Actuarial Consultant

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Ladies and Gentlemen, I am grateful to the Society for inviting me to make a contribution to your meeting.

My contribution takes the form of some random, but I hope fairly provocative, thoughts on pension related matters. Also, since pensions are a boring old subject, some of my remarks are intended to be a bit tongue in cheek - your task is to work out which.

First, though, the usual disclaimers. My comments are not to be taken as representing the views either of the Department of Enterprise and Employment, for which I work as a consultant, or the Telecom Eireann Superannuation Fund, of which I am Chairman.

You may recall that Voltaire, on his deathbed, was asked to condemn the devil with all his works and pomps. This was apparently common in those days. He is reported to have replied to the effect that this was hardly the time to ask him to make any new enemies. I'm conscious of this when I point out, in relation to the so-called pensions timebomb, that the timebomb, if there is one, can be rather easily decommissioned by the simple expedient of raising retirement ages. And is it not rather contradictory that a drive towards earlier retirement pensions should be proceeding hand-in-hand with increasing life expectancy? The 60/65 retirement age standard emerged in a certain set of demographic circumstances but why should it be set in stone?

I would argue that, in the case of social security, there are substantial advantages of paygo funding and substantial disadvantages of actuarial full funding. A fully funded social security scheme, if that were practicable, would be no more secure economically than a paygo scheme. Both schemes rely on the ability of the economy to create and transfer wealth. In other words, I would say that, for social security, the funding mechanism is more or less irrelevant. But how does one make these paygo systems viable over the next half century?

One could postulate an age-of-entitlement model as a possible solution. Under such a model, the age of entitlement for social security retirement benefits would increase in line with the balance of demographic trends.

A 1995 paper by a Canadian actuary entitled “Paygo Funding Stability and Intergenerational Equity” estimated, using Canadian data, that a wealth transfer equilibrium could be achieved in the Canadian case if the age-of-entitlement increased from age 65 in 2006 to age 69 in 2030. The author pointed out that an age-of-entitlement formula could be found to achieve any wealth transfer ratio deemed desirable - does this indicate, Chairman, that actuaries can be even better than academics at making the obvious sound erudite? He went on to suggest that all other western industrialised nations could achieve equity and stability with a smaller age-of-entitlement shift, on the basis apparently that the baby boom generation effect is more marked in Canada than elsewhere. The paper concludes by presenting what it calls a series of logical arguments in support of the contention that such an age-of-entitlement solution would prove to be politically palatable. Whatever about Canada, I am agog with anticipation at the prospect of a Minister for Social Welfare presenting these logical arguments to an Irish electorate! I fear that, if they were to be stated as being of actuarial origin, the only result would be to inspire a whole new raft of actuary jokes.

It would seem to be a necessary concomitant to an increasing age-of-entitlement that age at retirement would also increase. In one sense, perhaps it is rather surprising that increasing life expectancy has not created a demand for this. Is it not ageist to insist on age grounds that active people should desist from a gainful occupation?

Whatever about all this, the economy will of necessity adjust to changing demographics. Where we have some choice is in the manner of the adjustment and, here, the idea of varying age-of-entitlement allied to varying retirement age, whatever its practicability, seems to have at least a theoretical attraction. And, again, the basis of funding is essentially irrelevant since only current resources can meet current demands in any event.

The point has been well made that the potential problem for our social security system, while it exists, is less than is in prospect in many other countries. The two main reasons are, firstly, that our social security retirement benefits have been maintained at a more basic level than elsewhere (particularly, in that we have resisted introducing state earnings related benefits) and, secondly, that our demographic prospects are less stark than elsewhere. To my mind, however, the most encouraging thing is that the serious potential issues involved are arguably being addressed in this country in a more mature and less adversarial manner than in some other countries. I think it is important that a reasonable measure of consensus on long term pension issues should be achieved and the Department’s pension initiative seems to me to be a promising way to go about it.

I haven’t much to say about public sector pensions, mainly because all I have to say about them is already in a paper I co-authored for a Society of Actuaries seminar last year. I apologise for the plug. There are really only two points I wish to make here.

First, the outlay on public sector pensions will increase steadily over the next 25/30 years as the schemes mature, purely and simply as a result of the expansion of the public sector over the past 25/30 years. Pension costs will rise to constitute a quite significant percentage of total public expenditure but the growth in costs will be predictable and should be manageable. The second point is that the pressure for early retirement in the public sector seems to me to be particularly worrying in terms of the future viability of these schemes. Early retirement on actuarially reduced terms is one thing but that is not, of course, what is sought. Over time, the additional costs of early retirement arrangements can be horrendous and the problem in the public sector, given that the schemes are financed on a pay-as-you-go basis, is that the costs are not transparent in the short or, perhaps, even in the medium term. The public sector schemes are, by and large, excellent schemes and I have some apprehension that claims for early retirement on favourable terms may lead to pressures on the schemes which will damage them in the long run.

To turn to occupational schemes, attention has recently been drawn in an ESRI study to the relatively low coverage of such schemes and there is much interest internationally in the question of mandatory provision both to ensure comprehensive coverage and to complement social security. There have been interesting developments in some South American countries in this direction and mandatory requirements of this kind have also recently been introduced in Australia. There are echoes of this also in recent British Government proposals. Broadly, the idea is that employers and individuals are required to invest a certain percentage of earnings in tax advantaged pension arrangements, with the market in these arrangements being a competitive one. There is not enough experience yet to make a definitive judgement on these developments but they seem to be moving in a positive direction. I suspect a critical test may come if and when investment markets enter a prolonged bear phase and retirees find their benefits negatively affected. I wonder also whether a wide variation in investment performance by different pension providers will be as “acceptable” in the context of mandatory contributions as it currently seems to be where contributions are discretionary.

Perhaps the major issue for occupational pensions is whether the traditional defined benefit scheme has any future. Certainly, all sorts of circumstances are militating against the defined benefit concept, which would traditionally have been viewed as perhaps the most satisfactory form of pension arrangement. The unwillingness of employers to accept an uncertain future liability, increasing job turnover, the growing prevalence of fixed term job contracts, the growing complexity of regulation and the associated costs of compliance, and the pressure for early retirement options are all factors driving promoters towards the defined contribution or accumulation scheme. While new schemes nowadays are invariably defined contribution, I am not aware of schemes here which have converted yet from defined benefit to defined contribution. However, some very large schemes in Britain have done or are doing so.

It is difficult to say at this stage if or how much this trend is to be regretted. The transparency of the defined contribution concept and the clear relationship between the individual's contributions and his emerging fund could be said to be in tune with modern employment developments generally. Of course, the pension fund member is now directly at the mercy of investment returns and I suspect that there are many issues surrounding this to which Trustees will have to give increasing attention as time goes on.

Finally, I would like to say a few words about tax. The tax regime for pensions in Ireland is rightly benevolent. The fact that contributions can be offset against tax, that there is gross roll-up within the fund, that up to half the benefit on maturity may be taken as a tax free lump sum, adds up to a very favourable tax incentive package. Bearing in mind the near insatiable demands for Government expenditure, however, it would be wise never to become too complacent about the tax situation. Nothing could do more harm to the future of the superannuation sector than negative changes in public policy in this area and, indeed, we had a hint of that some years ago when a one year levy was imposed. Recent developments in Australia may be taken as something of a cautionary tale.

A few years ago, the last Australian Government had the bright idea that, since pensions in payment were taxable, it would be allright to bring forward the tax by levying a 15 per cent charge on pension fund income, to be recoverable later. The complexities and potential inequities of this can be imagined. When the new Government took over a year or so ago, it came into office with a Bush style "no new taxes" pledge. However, on concluding that it needed more money, it decided to raise it by imposing an additional 15 per cent surcharge on pension fund income relating to contributors above a certain earnings ceiling. Leaving aside the question as to its wisdom or otherwise, literally no one seems to know how this can be made to work. Queries from the Opposition on the lines of "when is a surcharge a tax?" and "when is a tax a surcharge?" have been a daily event ever since in the Australian parliament. Even more interesting is the fact that the Australian Treasurer, who is equivalent to our Minister for Finance, actually made a lengthy statement explaining why a surcharge is not a tax! There clearly needs to be eternal vigilance in this matter.

Thank you for your attention.