DÁIL ÉIREANN

AN ROGHCHOISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Céadaoin, 16 Feabhra 2022

Wednesday, 16 February 2022

Tháinig an Roghchoiste le chéile ag 5.30 p.m.

The Select Committee met at 5.30 p.m.

Comhaltaí a bhí i láthair/Members present:

Teachtaí Dála/Deputies	
Richard Boyd Barrett,	
Seán Canney,	
Pearse Doherty,	
Bernard J. Durkan,	
Michael Healy-Rae,	
John Lahart,	
Aindrias Moynihan,	
Ged Nash,	
Patricia Ryan.	

Teachta/Deputy Neasa Hourigan sa Chathaoir/in the Chair.

Indexation of Taxation and Social Protection System: Discussion (Resumed)

Chairman: Apologies have been received from Deputy Mairéad Farrell. Before we begin, I will explain some limitations to parliamentary privilege in the practice of the Houses as regards references witnesses may make to other persons in their evidence. The evidence of witnesses physically present or who give evidence from within the parliamentary precincts is protected pursuant to both the Constitution and statute by absolute privilege. Today's witnesses are giving their evidence in the committee room so we do not have to give the reminder about giving evidence remotely. Witnesses are again reminded of the long-standing parliamentary practice that they should not criticise nor make charges against any person or entity, by name or in such a way as to make him, her or it identifiable, or otherwise engage in speech that might be regarded as damaging to the good name of the person or entity. Therefore, if their statements are potentially defamatory with regard to an identifiable person or entity, they will be directed to discontinue their remarks. It is imperative that they comply with any such direction.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official either by name or in such a way as to make him, her or it identifiable. I remind members of the constitutional requirement that they must be physically present within the confines of the place at which Parliament has chosen to sit, namely, Leinster House, in order to participate in public meetings. I will not permit members to participate where they are not adhering to this constitutional requirement. Therefore, any member who attempts to participate from outside the precincts will be asked to leave the meeting.

Members and all in attendance are asked to exercise personal responsibility in protecting themselves and others from the risk of contracting Covid-19. Masks, preferably of medical grade, should be worn at all times during the meeting except when speaking. I ask that everyone co-operates with this.

Today's engagement is the committee's fourth meeting on the issue of the indexation of welfare and the taxation system. This is an issue that we will go into in some detail so I appreciate everybody's attendance. I welcome Mr. Joe Cullen, principal officer, income tax policy unit, and Mr. Matt McGann, principal officer, fiscal analysis unit, at the Department of Finance; Ms Jasmina Behan, acting assistant secretary, and Mr. Cathal McDermott, assistant principal, at the Department of Public Expenditure and Reform; and Mr. Ciarán Lawler, assistant secretary, Ms Aideen Mooney, principal officer, and Ms Saidhbhín Hardiman, assistant principal, at the Department of Social Protection. We will go to Mr. Lawler first, followed by Ms Behan and Mr. Cullen, if that is acceptable to everybody. I call Mr. Lawler.

Mr. Ciarán Lawler: I thank the committee for the invitation to speak. We have provided members with some briefing material in advance of the meeting, which I hope they found useful and informative. The issue of benchmarking and indexation of social welfare payments has been a topic of discussion for many years. It stretches back to the Commission on Social Welfare in 1986, through to the national pensions policy initiative in 1998 and the Final Report of the Social Welfare Benchmarking and Indexation Group in 2001, which was established under the Programme for Prosperity and Fairness. More recently, the focus has been on State pension payments. A Roadmap for Pensions Reform 2018-2023 proposed a benchmark of 34% of average earnings as a rate of payment with future increases linked to the consumer price index and wage levels. The Roadmap for Social Inclusion 2020-2025 presented a defined approach to benchmarking and indexation of pensions, known as the smoothed earnings approach. This is the approach that has been considered and endorsed by the Commission on Pensions and, along with other commission recommendations, will be considered by the Government in the weeks ahead.

As the committee is fully aware, the rate of State pension each year is decided as part of the budgetary process. The introduction of a system of benchmarking or indexation can help to alleviate some of the difficulties inherent in that process. I will highlight a few of them. First, with no explicit link between pension rates and earnings, the real value of pensions relative to market-based earnings can deviate from year to year. Similarly, with no link to prices, the real value of pension rates can lead ahead of, or lag behind, changes in prices. Second, the uncertainties created by the current process, given the scale of spending on pensions, make public expenditure planning and budgeting across all of Government uncertain. It is worth noting the Department of Social Protection is now the highest spending Government Department and pension expenditure will comprise approximately 40% of the Department's entire budget in 2022. Third, workers planning retirement arrangements face significant uncertainty with regard to the real value of the State pension at retirement, which impacts upon their ability to make appropriate private pension arrangements.

A number of approaches could be taken to indexing pensions, some of which witnesses have outlined to the committee over the past number of meetings. While not exhaustive, these include indexing to rises in prices; indexing to rises in earnings; indexing to a certain percentage increase each year; or indexing to the higher of a number of indicators. Again, there can be difficulties with each of these approaches. For example, linking to prices only would risk pensions falling behind average incomes in society generally, linking to earnings only may lead to the real value of the pension falling during periods of high inflation, and increasing to a set percentage each year does not take account of either earnings or prices and, while it guarantees certainty to pensioners, does not take account of developments in the wider economy. Finally, linking to the higher of a number of indicators leads to a ratchet effect whereby the rate, over time, will exceed all of the indicators chosen and outstrip both earnings and prices. As noted by the Commission on Pensions, this can lead to fiscal sustainability issues and has been a recent subject of controversy in the United Kingdom, which has adopted a triple-lock approach.

The smoothed earnings approach endorsed by the Commission on Pensions seeks to overcome this by smoothing pension increases over time, anchoring to a particular benchmark such as a percentage of earnings, but indexing the pension rate to prices during periods where inflation outstrips earnings. In subsequent years, when the value of the benchmark exceeds a prices-adjusted rate of pension, it is again tied to the benchmark. In effect, over time this anchors the pension rate to the benchmark level over the medium term.

Ireland is an outlier in not having a benchmarking or indexation mechanism for State pensions. Throughout Europe and beyond, governments have adopted approaches to calculating state pension increases that rely on earnings or prices indicators – or a mix of both – to determine annual pension rates. Having said that, to adopt this approach would be a fundamental shift in how budgetary planning decisions are made. In this regard, as outlined in the Roadmap for Social Inclusion, the approach could be overseen by an independent, expert body and could operate in a similar manner to the Low Pay Commission by making annual recommendations to the Government. The body could also periodically review the effectiveness of the approach.

In the time permitted, we hope to give the committee an insight into current thinking around the benchmarking and indexation approach under consideration. I thank the Chairman. My colleagues and I are happy to respond to any questions members may have.

Ms Jasmina Behan: I thank the committee for the invitation to speak with members on the issue of benchmarking and indexation. My colleague from the Department of Social Protection has already outlined the background to benchmarking and indexation in relation to the State pension. The report of the Commission on Pensions from October 2021 and the accompanying technical working paper on benchmarking and indexation set out an overview of the proposed policy recommendations and the key considerations relating to these recommendations. Previously, officials in the Department of Public Expenditure and Reform worked closely with officials in the Department of Social Protection on possible approaches to applying benchmarking and indexation to the State pension in advance of the publication of the Roadmap for Social Inclusion 2020-2025, which was published in January 2020.

One approach discussed in the roadmap was referred to as the smoothed earnings approach. This approach was endorsed by the Commission on Pensions in its report, which was published in October last year. I will talk through the mechanism of the smoothed earnings approach in more detail and highlight some important considerations of potential changes to determining the State pension rate from a public expenditure management perspective. Broadly, the smoothed earnings approach is based on two parameters: growth in wages and growth in prices. Using wage growth as the benchmark, the State pension is calculated as a percentage of average earnings. This percentage has frequently been assumed to be set at 34% based on an analysis from the Economic and Social Research Institute, ESRI, dating back to 1996. By benchmarking the State pension rate to 34% of average earnings each year, changes in earnings are reflected in the basic State pension rate.

The second component of the smoothed earnings approach applies price inflation to the calculation. Here, the pension rate is adjusted using the harmonised indices of consumer prices, HICP. Both the consumer price index, CPI, and the HICP are designed to measure the change in the average level of prices paid for consumer goods and services. The HICP has gained prominence in recent years as it enables comparison across EU member states. Its main difference from the CPI is that it excludes items such as mortgage interest, motor tax, house and car insurance and trade union subscriptions. The HICP and CPI are typically very close in their measure but the HICP has marginally been the higher indicator of the two in recent months.

Once the pension rates are calculated, the smoothed earnings approach uses the higher of the 34% earnings benchmark or HICP growth over the period to determine the increase in the rate. The smoothed earnings approach is designed to preserve the real value of pensions over time and to keep pace with both inflation and earnings, whichever is growing faster. Linking pension payments to developments in earnings and prices in this way can provide greater certainty to individuals and to public expenditure planning. If implemented, it could bring Ireland's approach to determining the appropriate pension rates more in line with other countries.

However, benchmarking and indexation would be a fundamental policy change which also gives rise to important considerations in relation to managing the public finances. Future pressures on the public finances due to an ageing population are well documented. Expenditure on the State pension is due to increase considerably as a proportion of modified gross national income, GNI, over the coming decades. Department of Finance calculations included in the pensions commission's report estimate that expenditure on social welfare pensions will increase from around 3.8% of modified GNI in 2019 to 5% by 2030, assuming that the pension age is retained at 66. By 2050, this estimate increases to 7.9%.

A change in policy such as implementing the smoothed earnings approach would impact on the current budgetary discretion available to the Government, which allows for consideration of the overall prevailing economic conditions. Periods in which both earnings and prices are both falling, and periods in which the public finances are under pressure due to economic conditions, could represent problematic scenarios for the application of the smoothed earnings approach. The Government is currently considering the recommendation of the pensions commission to establish a pension rate commission. While the presence of such a commission may help with the deliberation process for applying a benchmarking and indexation approach, there is also the consideration of the administrative complexity and cost that may arise. The Government is due to deliberate on the pensions commission's recommendations by the end of March this year.

I hope that gives this committee an insight into the high level detail of the benchmarking and indexation approach under consideration for pensions and the key considerations in relation to the public finances. My colleagues and I will be happy to take any questions committee members may have.

Chairman: Thank you, Ms Behan. Mr. Cullen from the Department of Finance is next.

Mr. Joe Cullen: On behalf of the Department of Finance, I thank the Chairperson for the invitation to appear before the committee. We are happy to provide the Department's expertise to support the committee in examining the question of indexation of the tax and welfare system and, in particular, the rationale for and against indexation of the tax system; the approach that might be taken, including how it might operate; and how automatic indexation might affect budgetary sustainability.

We have followed very closely earlier discussions which the committee has had with other contributors over recent weeks. Those discussions have covered in some detail the rationale behind indexation of the tax and welfare system and we are happy to make available our analysis to further inform the discussion today.

The Department of Finance's responsibility, and hence expertise, in this area largely relates to tax policy. However, the Department also has responsibility for overall fiscal sustainability. In that regard, as part of our contribution, we can outline the extent to which the EU fiscal rules impact on budgetary flexibility and, in particular, how the rules would account for a system of automatic indexation, as compared with the present approach.

In terms of the underlying rationale, when welfare support payments or personal income tax credits and bands are increased in a particular year while earnings and prices are rising, such an approach seeks to ensure that the purchasing power of welfare supports is maintained and the value of take-home pay for those at work is preserved. Our ESRI colleagues indicated during their appearance earlier this month that indexation of tax and welfare changes in line with wages growth as opposed to prices growth is the only way to ensure that welfare recipients and workers see their income grow at the same rate. We also note in this regard that the current programme for Government contains a commitment that from budget 2022 onwards, "in the event that incomes are again rising as the economy recovers, credits and bands will be indexed linked to earnings." The question of whether the base reference for the index used should be prospective or retrospective is also a point for consideration and it is brought into particular focus at the moment by current price and wage movements.

A further key point made by our ESRI colleagues, one which we would underline, is that, historically, changes to tax and welfare parameters have, on average, kept pace with earnings. This aligns with the Department's own analysis when we look at the effect of budget changes over time on the personal income tax system. The picture as it applies internationally was addressed in detail by the ESRI in its presentation to the committee. In our view, it would be important to explore this aspect and reflect carefully on any learnings, while remaining cognisant of the fundamental differences in approach to taxation and welfare that exist across countries.

In relation to the steps that might be required to create an indexation system, these would initially be likely to require policy decisions regarding the scope of the change. Questions in this regard include whether it would involve both the tax and welfare systems; whether it would apply to all elements and supports or just a key subset; and whether the same degree of indexation would apply to both systems in any year. Other questions include whether indexation should take place by reference to increases in wages or prices; whether the index used would be retrospective or prospective; whether, and to what extent, a facility for discretion to suspend or modify the system in any particular year would be built into the arrangements; and whether the system would be placed on a statutory footing or something less binding, for example, a set of non-statutory guidelines.

Were such a system to encompass both tax and welfare, it would be likely to require in advance of the annual budget close co-ordination and co-operation at the political and official levels across a number of Government Departments in order to discuss and agree matters such as the degree of any deviation from the expected extent of indexation, if the system allowed for this and, of course, the percentage index to be used.

Returning to the issue of the rationale for having a system of automatic indexation, a key attraction of such an approach is that it might be expected to give more certainty to beneficiaries on both the tax and welfare sides, both individuals and families, from year to year about the value of their income or take-home pay and entitlement to supports. At the same time, as has been pointed out by contributors previously, the main drawback is that, to the extent that automatic indexation might apply, it would limit or curtail Government flexibility around the discretionary allocation or non-allocation of resources in any particular year. This would be likely to have practical implications not only within the tax and welfare systems but also for the allocation of resources for support and incentive schemes across a wide range of other areas of government.

As noted earlier, the approach of successive Governments over the years has been one where automatic indexation has not applied each year and where budgetary flexibility has been retained in large measure from year to year. However, as has also been noted, this approach has delivered results which are broadly similar to what would have been achieved if indexation to earnings growth had been in place. Ultimately, the question of annual automatic indexation is one of political choice and preference.

I thank the Chair and members of the committee for their attention. We are happy to provide further information or clarification on any point.

Chairman: We have many witnesses with us today, so if anyone wishes to contribute on a question, I ask them to indicate and I will keep an eye out. I call Deputy Aindrias Moynihan.

Deputy Aindrias Moynihan: I thank Mr. Lawler, Ms Behan and Mr. Cullen for the presentations and overviews provided. Mr. Cullen answered a chunk of the questions I had in the context of the earlier contributions. Much of the focus seems to be only on the pension. Have other social welfare payments been examined in this context, aside from the pensions? I refer to payments made to younger people, jobseeker's payments, the working family payment. WFP, etc. Has all the focus in this process been on people of pension age? Equally, in respect of side benefits, such as the fuel allowance and medical card and those qualifying thresholds, has consideration been given to indexing them as well, or is there a narrow focus on the pension rate itself? I ask for some details on this point. Turning to another matter, is it only the State pension being considered in regard to this process or is there also scope for making changes to semi-State pensions, such as those paid by Aer Lingus, ESB, etc? The recipients of those pensions have been clear that they have not had any rise in several years, and their pensions are also being threatened by the impact of PRSI changes now as well. I wonder where pensions such as those fit into the picture.

Turning to the taxation side, and Mr. Cullen outlined several aspects in this regard, it seems that what is being talked about is a proposal in respect of income tax for pensioners and younger people as well. I would like some clarification on this point and where it is felt that it would be appropriate to draw a line in this regard. In addition, to get this clear in my mind, I would also like some more detail regarding what was said about it being felt that the system, as it is working, has been yielding similar results as if there had been indexation, even though there has not been in recent years. Is my reading of this correct?

Chairman: Who would like to contribute first? I call Mr. Lawler.

Mr. Ciarán Lawler: Regarding the first question, the focus and only real policy position the Government has taken concerning benchmarking and indexation now is on State pensions. There is a commitment in the national roadmap for social inclusion to examine other social welfare payments. The focus to date has been on State pensions, but we will be turning to other working-age payments, along the lines the Deputy spoke about.

Deputy Aindrias Moynihan: I ask Mr. Lawler to comment on the semi-State pensions.

Mr. Ciarán Lawler: The Department of Social Protection would not have responsibility for occupational or public sector pensions. They do not come under the remit of this benchmarking indexation process. The focus has been on State pensions to date. When we turn our attention to working-age payments, that will be a much more complex area. There are many different rates of payment. For example, people on jobseeker's payments are on different rates to those on invalidity pensions or on a carer's payment. It is more complex to determine where to set the benchmark when dealing with more than one payment.

Deputy Aindrias Moynihan: If the focus is on the pensioner and the State pension rate, is there a possibility of also exploring the qualifying thresholds for a medical card, the fuel allowance, etc.?

Mr. Ciarán Lawler: Again, the current focus is on the primary rate of payment when we are examining indexation or benchmarking, rather than on ancillary payments such as the living alone allowance or the fuel allowance. Many of those ancillary payments are used to target resources at groups of people who are most vulnerable, for example, in the case of the living alone allowance, and others. There may need to be some discretion for the Government to target payments in a particular year at particular groups more at risk of poverty, for example.

Chairman: I invite Mr. Cullen to address some of the Deputy's questions.

Mr. Joe Cullen: Regarding the question as to whether the indexation of the tax system would apply to pensioners and younger earners, the starting position is that the tax system applies to all income earners, from zero and right up the income spectrum. The starting position if there were to be indexing of bands and credits is that it would apply to everyone. On the issue of what has been achieved in the absence of having a system of automatic indexation in place, I will give a concrete example. We have taken figures for average earnings from the Central Statistics Office, CSO, publications and looked at the years from 2014 right up to the impact of budget 2022, which was a period when the economy began to stabilise after the financial crisis. In that time, a person on the average wage back in 2014 would have been earning around €36,000. The current equivalent average earnings figure is €44,191. The effective rate of tax on those two figures has varied slightly over that time, but not much. It was 21.8% in 2014 and, after budget 2022, it is now 22.5%. Therefore, it is broadly similar. This would suggest that the tax changes we have introduced have broadly kept pace with increases in earnings over that fairly decent period of eight years. If we look at married couples with one earner, people in that situation have done even better. In 2014, their effective tax rate was 13.1%. That has reduced after budget 2022 to 11.7%, and this has been largely due to the impact of the increase in the home carer tax credit over that time. Those are just some brief examples of how the system has matched the growth in wages over that time.

Chairman: Ms Behan has indicated that she wishes to contribute.

Ms Jasmina Behan: Regarding other types of pensions, in the context of public service pensions, there are two different cohorts and different indexation policies. For those who are members of the single scheme, or the single public service pension scheme, their pensions, under section 40 of the Public Service Pensions (Single Scheme and Other Provisions) Act 2012, are updated in line with the increases in the consumer price index. For those whose service began predating 2013, their pensions are increased in line with pay increases, where necessary, to ensure that they are equal to the pensions being awarded to the same grade of retiring staff.

Deputy Aindrias Moynihan: Okay. Any ESB or Aer Lingus people who have been on to me about the change to PRSI have been adamant that they have not seen any increase in their pension payments for some time. It is interesting to hear what has been said in this regard. Those were the few points that I wished to check out. I might come back in later, if there may be an opportunity to do so.

Deputy Pearse Doherty: I welcome the witnesses to the committee. I have just a couple of questions with regard to indexation. Perhaps I will start with what happened in budget 2022. Will the witnesses clarify how core social welfare payments were indexed in budget 2022? What methodology was used?

Chairman: Is that question for the Department of Public Expenditure and Reform? I am sorry; it is for the Department of Social Protection.

Mr. Ciarán Lawler: The decision of the Government at the time was to implement a flat-rate increase of €5 per week across all social welfare payments. There was no policy on indexation, nor is there an official policy on indexation or benchmarking at this point. We are looking at it for pensions, as I have said, but the policy in recent years has been to implement flat-rate increases and increases for targeted payments such as the living allowance or qualified child allowances.

Deputy Pearse Doherty: Was there any recommendation from officials in the Department with regard to the rate working-age payments should be set at in the future in the context of the discussions on budget 2022?

Mr. Ciarán Lawler: In the context of budgetary discussions, a number of proposals for rates or changes to schemes or means testing are presented to the Government along with their associated costs. The Government then decides on the budget package within the available resources.

Deputy Pearse Doherty: Did any of those proposals include indexation?

Mr. Ciarán Lawler: They related to the cost of particular nominal increases to the rates of payment.

Deputy Pearse Doherty: Up until now, the Department has never looked at the indexation of social protection payments. Is that correct? It basically just gives the Minister a table showing what it would cost if a given payment was increased by €1 or €2 and so forth. Has it ever brought the issue of need into it? This fiver for everybody is a political decision. It is not based on the needs of people, which is what the Department is supposed to respond to. I am surprised that it has never presented a paper to its Minister showing where inflation is and what would be required to index payments to the rate of inflation or showing where wages are at and what would be required to index payments to that. Is Mr. Lawler telling me that such an exercise has never been carried out by the Department of Social Protection?

Mr. Ciarán Lawler: We do have such forecasts available to us at budget time. For example, at the time budget 2022 was formulated, the rate of inflation forecast was just above 2%. We take a range of research and indicators into account when looking at changes to schemes and changes to rates. These include data and statistics on income and living conditions and the minimum essential standard of living research produced by the Vincentian Partnership for Social Justice. That guides and informs us as to the areas to focus on with regard to changes to schemes from one year to the next.

Deputy Pearse Doherty: To go back a step, was any proposal given to the Minister for consideration with regard to indexation to the rate of inflation in last year's budget?

Mr. Ciarán Lawler: We were aware of the forecast rate of inflation but, as to whether the proposal was formulated to correspond exactly with that rate, the issue was really one of nominal increases.

Deputy Pearse Doherty: That is fair enough because the way the political system has always acted here has been to provide a fiver or whatever it is. It has always been a flat rate rather than being based on need or some reference point with regard to wages or increases in the cost of living. Now that we know where we are at this point in time, with the rate of inflation higher than 5%, by how much would working-age payments have had to increase in last year's budget just to meet the rate of inflation in wider society?

Mr. Ciarán Lawler: As was referenced earlier, it depends on whether you are looking forward or backwards. I know that a number of witnesses have brought up this issue over recent weeks. If you look backwards to see what the rate of inflation was over the previous 12 months in order to use that information to forecast increases in the social welfare rates for the following year - and I am talking about inflation in prices alone and not about earnings - you will see that the rate of inflation was actually negative. However, the forecast at budget time was the rate would be just over 2%. For a normal working-age payment of €203, an additional 2% would have been worth €4. In the subsequent period, the rate of inflation has increased to 5% or 6%. The last forecast I saw suggested it will average at 4% over the course of the year. If you had that information about the next few months available to you at the time the rates increased, that

5% would have equated to €10 while 4% would have equated to €8 for those on a jobseeker's payment. However, that information was not available last September and October.

Deputy Pearse Doherty: I understand that. Without those increases, given where we know the rate of inflation to be now, all of those households are going to become poorer this year. An indexed increase would have been €10 but €5 was given. The value of their payment is therefore €250 less over a year. Is that not correct?

Mr. Ciarán Lawler: It would depend on the composition of the household because other measures were taken in the budget, and in previous years' budgets, with regard to increases in, for example, the qualified child allowance. This was again informed by research on the minimum essential standard of living. There were also changes to the fuel allowance and to means tests. If he is just looking at the primary rate, the Deputy is correct but, if he looks at this issue in the round, it depends on the family type and the individual circumstances.

Deputy Pearse Doherty: In fairness, no matter what happened in last year's budget, the fuel allowance will not come anywhere near the inflation facing households this year, which equates to an extra €700. I would say Mr. Lawler would accept that.

Where is the Department's head, and that of the Department of Public Expenditure and Reform, with regard to indexation? We are always hearing Ministers saying that they are indexing but, here in the Committee on Budgetary Oversight, we are hearing that they are not or, if they are, they are indexing to something in their heads because they are not indexing to either past or forecast wages or inflation. Where is the policy going? Mr. Lawler said there was no policy at the time and that there is none now with regard to indexation. Is a policy being developed? Is there a plan to develop one? Are we going to be looking at indexation? People have been saying that the rate of inflation may reduce and come back under 2% in the coming years or possibly even next year. However, those increases have already been baked in. Unless there is a negative rate of inflation, those increases are baked into the system. Those costs are recurring. Will Mr. Lawler give us an outline of the thinking within the Department with regard to indexation?

Mr. Ciarán Lawler: To go back to my comment that there was no policy, the policy has been one of flat-rate increases. That has been the policy over the last few years where there have been increases.

Deputy Pearse Doherty: To clarify, that is not indexation.

Mr. Ciarán Lawler: No, they were flat-rate increases. There is no formal indexation policy.

Deputy Pearse Doherty: That is fair enough. It is not a policy of indexation.

Mr. Ciarán Lawler: As I outlined in the opening statement, we are moving towards an indexation policy. The Government is now considering the recommendations of the Commission on Pensions, which has endorsed a smoothed earnings approach to benchmarking and indexation of State pensions. That is where we are at the moment. We also have a commitment in the national roadmap for social inclusion to examine indexation policies and benchmarking for the wider family of social welfare payments, including working-age payments. That work has yet to be done. At the moment, the focus has been on State pensions.

Deputy Pearse Doherty: Mr. Lawler mentioned the Commission on Pensions, the work done by the Vincentian Partnership for Social Justice and the minimum essential standard of living, MESL, rate, the rate required just to get by. In terms of the different categories of people, who is further away from those rates? Is it pensioners or, for example, single parents or those depending on working-age payments?

Mr. Ciarán Lawler: For clarity, when the Deputy says further away from those rates, is he referring to the minimum essential standard of living, MESL, rates?

Deputy Pearse Doherty: Yes, the MESL rates.

Mr. Ciarán Lawler: I have some data here. It depends. Obviously, there are numerous family types. I refer to a lone parent with two children, for example-----

Deputy Pearse Doherty: Is it not the case that pensioners are closer to the rates, if not at the rates in some cases, depending on the composition, than, for example, lone parents or those depending on working-age payments?

Mr. Ciarán Lawler: That is correct.

Deputy Pearse Doherty: It is correct. I want to challenge the Department on policy-led and needs-led assessment. Our guests referred to indexation for pensioners. Obviously, I am not arguing against that; I support the increase in the pension, which Sinn Féin has called for. However, to do that as a priority in light of the fact that those who are more at risk of poverty are actually in the other categories does not make any sense to me.

Mr. Ciarán Lawler: To go back, the rate of pension has tracked approximately 34% of average earnings for several years. The result of that seems to have been that, as the Deputy stated, when one looks at statistics on income and living conditions, such as those in the context of the minimum essential standards of living, for example, pensioner rates of poverty tend to be lower, on average, than other groups in society. The first thing that shows is that some level of indexation or benchmarking, even if it is informal rather than formal, seems to work in maintaining living standards. If one looks internationally, the focus has been on pensions. We have a commitment to look at a benchmarking and indexation approach for working-age payments. That is in the roadmap for social inclusion and it is what we will be doing in the coming period.

Deputy Pearse Doherty: When will that start? When will it be concluded?

Mr. Ciarán Lawler: As I stated, it is a much more complex issue. We have been looking at benchmarking and indexation for many decades. We now have a policy position in respect of pensions, as well as a recommendation from the pensions commission. Working-age payment rates are far more complex. As I stated, there are various rates of payment. There are different groups of people in different circumstances, such as jobseekers, people with disabilities and lone parents. Some of those payments are on different payment rates. Several factors that need to be considered in the context of working-age payments are not as relevant when it comes to pensions. We will start the process this year. I do not have a conclusion date for the reasons I have outlined. We have other commitments to examine in respect of working-age payments, such as pay-related benefit and the concept of a working-age payment which would, if implemented, change the structure of the social welfare system.

Deputy Pearse Doherty: I will make a final point. I thank Mr. Lawler for his responses.

Chairman: The Deputy has reached the end of his slot. He may ask one question quickly.

Deputy Pearse Doherty: I will ask a quick question. When Sinn Féin puts forward its alternative budget, we look at those closest to the risk of poverty. It is not a case of €5 or €10 for everybody. Lone parents are further from where they need to be. Those with disabilities have an additional cost. Does the Department not see that? I know it is complex, but there is evidence that there has to be a little bit of additional support for certain cohorts of individuals.

Mr. Ciarán Lawler: Sure. If one looks at the decisions that have been made in recent years, there has been a rate increase but there are also other measures. For example, we have increased the earnings disregard on the one-parent family payment in recent years. We have introduced a new structure to qualified child payments, informed by the minimum essential standard of living, and increased qualified child payments more significantly for over-12s. There have been changes to ancillary payments such as the fuel allowance. There have been changes to the living alone allowance. Even in the context of pensioners or people with disabilities, if they live alone, they are more at risk of poverty. There have been many targeted increases on top of the simple rate increase. That is where we look at the issues the Deputy mentioned.

Chairman: I thank the Deputy. Our next contributor is Deputy Michael Healy-Rae. We will give him a moment to gather himself. Is Deputy Boyd Barrett prepared to contribute?

Deputy Michael Healy-Rae: I am fine; I am just listening to the proceedings. My apologies to Deputy Boyd Barrett.

Deputy Richard Boyd Barrett: No problem. I am glad Deputy Healy-Rae is okay.

Deputy Michael Healy-Rae: The Deputy may carry on now. I thank the Chairman.

Deputy Richard Boyd Barrett: From where does the benchmark of 34% to which Mr. Lawler referred come? Is it standard across Europe that pensions should be 34% of average earnings? It is not a lot. He stated that average earnings are €44,000 at the moment. It is not really a lot. What is the particular rationale for that figure? Is it just tradition? Where does it come from? Is there any variation across Europe in that benchmark of pensions being 34% of average earnings? In other words, is it more or less, in general, in other countries? Does Mr. Lawler have any sense of those comparisons?

On the issue of other payments, as other Deputies have noted, much of this discussion is focused on pensions and the possible indexing of pensions against inflation or wages, or a combination of the two, or other indexes, but not other payments. If I heard Mr. Lawler correctly, he stated it is more complicated in those areas. Is it done elsewhere? I am not sure why he would say it is more complicated. I take the point that there are many different types of payments, but all these welfare or pension payments are quite low and people who are on them are pretty much at the lowest levels of income possible. I am not sure why there would be a rationale for not indexing all social welfare payments in some shape or form to ensure they retain some value or do not fall behind inflation or that a gap between those payments and average wages is not widened. I am curious to know whether this is done internationally. Why are we not looking at all of these payments to ensure they are indexed? Obviously, this is a live issue, given the current inflation rates. Certainly the €5 flat rate increase introduced in the budget seems very inadequate in the face of the level of inflation and the rising cost of living we are seeing at the moment for all recipients of pensions and social welfare payments, so we need to do something to make sure these payments do not fall behind racing levels of inflation if they occur.

I understand the difficulty. If it is pinned to wages and inflation is racing ahead of wages, there is a problem. If it is pinned to inflation but not to wages, the gap between average wages and pension or social welfare payments potentially widens if wages increase ahead of inflation. It seems some combination of both those elements would probably be the best, although I am interested in hearing an opinion on that. I cannot see it being more complicated. I would imagine it would be best to have all those options available to us and then have some sort of hybrid that would still be flexible enough to take into account changing circumstances. There would be a minimum level of indexation but also discretion to deal with unusual circumstances or particularly marked changes that may leave the basic method of benchmarking inadequate in dealing with problems emerging either in terms of inflation, the cost of living or increasing gaps between social welfare and pension payments and earnings in society. Those are my thoughts and questions.

Chairman: Does the Deputy wish for those to be directed to a particular Department?

Deputy Richard Boyd Barrett: Not particularly. It is for anybody who feels like responding.

Mr. Ciarán Lawler: I will start where the Deputy finished. He spoke about some kind of a mix between earnings and prices, with some kind of oversight for times when something unusual is happening. That is the proposal endorsed by the Pensions Commission for State pensions. It is exactly the mechanism described by the Deputy. One cannot choose a benchmark that exists forever without some kind of review of effectiveness. That is what is proposed for pensions.

The Deputy mentioned that he does not see why there could not be a rationale for not indexing all social welfare payments. He could be absolutely right and it is something we must analyse in order to see how such a system would work. Would it be exactly the same as what is being proposed? We do not know. Would it be some kind of other indexation? We do not know. Where would the benchmark level be set? Would the benchmark be the same for all social welfare payments or would disability payments be different from jobseeker payments, for example?

When we speak about complexity, it relates to the range of payments and circumstances that people are in and what they need. There is also the fact that there are already different levels of payment for different circumstances across the system. That is what I mean by complexity, and it will require thought. Generally, across the system in Europe and beyond, the focus to a large extent in most countries is on pensions, and probably for the reasons I have just described relating to complexity when dealing with working age payments. We will start to look at it this year.

The Deputy asked where the 34% figure came from. This has a long history dating right back to the Commission on Social Welfare in 1986, for example. It set a kind of nominal rate, although I cannot remember if it was £50 or £60 at the time. The Pensions Board looked at it in 1998 in the context pensions and converted it to a percentage of earnings at the time. Pension rates have largely tracked that benchmark over those years and subsequently. As I mentioned to Deputy Pearse Doherty, if we consider poverty levels among older people on a general basis, they are lower than for other groups in society.

Ms Jasmina Behan: I echo the comments of my colleagues from the Department of Social Protection. The 34% figure has a long history, with the ESRI first calculating that the rate should range between 24% to 34% of the gross average industrial earnings. That view was also endorsed by the national pensions policy initiative in 1998. The benchmarking and indexation group in 2001 was divided on the view but a majority indicated a figure of 27% of gross average industrial earnings, with a minority favouring a 30% figure. The national pensions review board continued to recommend the social welfare and pensions figure of 34% of gross average industrial earnings. The roadmap for pensions reform 2018-2023 also put that forward. The 34% figure is the benchmark at which the rate is initially set but once it is locked, it is about the movement, as it is linked with earnings as always being 34%. It matters at the start what is the figure but it just moves together. The key issue is that once the rate is set, we are basically ensuring if we go with the parameter that the pension moves at the same pace as wages.

To echo previous comments, the complexity in looking at all welfare payments arises because there is a multiplicity of payments. The first question is whether all or some payments will be considered; if only some are to be considered, we need to figure out how the process interacts with the rest of the payments. Another question is what parameter is to be used, and whether it is to be prices, wages, a double lock or other approaches. There is a cost implication of various options that must also be considered. There is also the consideration of how these changes in policy will affect the labour market, incentives to work, replacement rates and so on. There is much complexity that must be considered when looking at indexation and benchmarking of all welfare payments.

Mr. Matt McGann: The Deputy made an apposite point about the need to maintain some kind of flexibility. Most countries that have some kind of indexation maintain a kind of escape clause. We can look at what happened with wages over the past two years. As a result of compositional movements and low earners falling out of work, the average wage was increased and we got anomalous very high wage growth. That happened in the UK, which has a triple lock, and there was wage growth of 8%; despite the lock, it was just not possible to deliver on that. One must maintain some kind of flexibility or escape clause to deal with those kinds of anomalous positions.

Deputy Richard Boyd Barrett: We do not have a policy on this now so no indexation *per se* was considered in the context of the budget. In the options made available to the Government now or which could be made available to the committee, Governments or anybody considering the matter coming up to a budget, how easy would it be to set out what the different options for indexation would deliver in advance of a budget? That would leave a range of options. Is this done elsewhere? In other words, we would know that if wages were benchmarked in a certain way, there would be a certain outcome in the budget. The benchmark could be against inflation or there could be a hybrid approach. This would allow us to consider options and modelled examples. It is a bit hard to envisage this over a long period because there are so many variables, including wages, anomalies or inflation surges. It is about having different options for indexation, while having indexation of some sort written into the process. I hope I am explaining my question correctly.

Chairman: The Deputy is explaining it. Does someone wish to respond on how easy it is to model various versions of this?

Mr. Ciarán Lawler: It is another “it depends” answer. It depends on the model one is using. It would be straightforward to project increases in social welfare payments based on indices you have at the time, such as projected inflation or earnings for the following year. That is a percentage, so you apply that percentage increase to the rate and come up with a number. If the inflation forecast at budget time turned out to be what it was, which was around 2%, that would translate to an increase of around €4 on the €203 rate of payment or a €5 increase on the pension. That can be done. When you are looking at things like the smoothed earnings approach or some kind of combination, it is a little more complex than that.

Ms Jasmina Behan: In terms of mathematical modelling it would not be difficult. The challenge is around agreeing on the parameters for the model and considering what those would be. For instance, even a simple thing like looking at inflation could vary depending on whether we measure over three months or year-on-year for a year, particularly at a time like this when there is an unusual type of behaviour. That is why, as I said, to consider the policy we need to really examine how all the parameters we want to include in the model are designed in a way that is appropriate. Those things are difficult but once we agree on the parameters the mathematics are not difficult to do.

Chairman: Does that answer the Deputy's questions?

Deputy Richard Boyd Barrett: It does. I thank all the contributors.

Chairman: I will come in with some of my own questions now. This may be a question for the Department of Finance. Does automatic indexation, even if it was something we could pause or set aside at points, help more generally with budgetary forecasting? I am thinking in particular of the kind of budgetary forecasting in reference to demographic planning and so on. Is it useful as a tool in that sense?

Mr. Matt McGann: That is a good question. Ultimately all our budgetary forecasting, to some degree, comes down to future projections. Whether we have indexation or not, we are able to calculate the cost but it is all dependent on the projections for growth, wages, etc. I do not think that it necessarily helps in the accuracy of the budgetary forecasting because we can say what we will have or what we will not have, depending on whether we index, but there is still a bound of uncertainty over both answers because they are both running off the same underlying projection of what growth or wage growth is.

Chairman: Would it provide an expected baseline of Government action?

Mr. Matt McGann: Okay, I see the Chair's point that it removes uncertainty over -----

Chairman: It removes a certain amount of interpretation out of the process.

Mr. Matt McGann: I think the Chair means that if we had automatic indexation it removes a degree of uncertainty over the budget policy decisions.

Chairman: Yes.

Mr. Matt McGann: That would, in theory, be the case. It remains to be seen how it would pan out in practice, to be honest. Coming up to a budget, if there was automatic indexation, it could eat up all of the available fiscal space. Previous contributors have spoken about indexing to prices or wages being fiscally neutral. In theory, *ceteris paribus*, all other things being equal, that is the case. However, for instance, it is perfectly imaginable that there could be a rate of inflation in another expenditure component that is above prices. For example, health inflation can run quite high. You might need greater flexibility or resources to allow for expenditure in other components that means that when the Government gets to budget day it will still be faced with a trade-off where if there is automatic indexation it will not be able to deliver on existing levels of services of health. In theory, yes, it does give more certainty that you know what is going to happen on budget day but it is hard to see that you would not need to maintain some degree of flexibility for what you know will be the case.

Chairman: Broadly, the systems in the EU that we have looked at have allowed for a get-out clause or for it to be set aside. One reason I ask this, and maybe it is a nebulous question, is that Mr. Paul Johnson of the Institute of Fiscal Studies was at the committee last week. Much of the session was spent talking about when and how it was set aside and how indexation had not constrained the British Government particularly because it was quite quick to break the bounds of indexation when it felt it needed to. It has had it since the 1970s, I think. However, I was surprised that when asked at the end of the session if it had had an impact generally on budgetary operations, forecasting and the general operation of budgets, Mr. Johnson was very positively inclined to say that it had. Even though it has been set aside, it had set a kind of baseline whereby everyone understood what the parameters of operation were.

Mr. Matt McGann: I can see the case to be made there. It gives a baseline so that there is a starting point assumption at least -----

Chairman: Right, okay.

Mr. Matt McGann: -----and then you might depart from that.

Chairman: Do any of the Departments here have an estimate of the cost of a smoothed earnings approach if we were to implement it this year?

Mr. Ciarán Lawler: If we were to implement it in budget 2022?

Chairman: I will take an answer for 2022 or 2023 if Mr. Lawler can give me a sense of it.

Mr. Ciarán Lawler: The first caveat is that if we are looking at an earnings benchmark and looking back at either 2021 or 2020 to calculate that, earnings were skewed in both years because low-income workers were disproportionately affected by the pandemic and lost their jobs. Therefore it resulted in an unusual increase in earnings. If you were to use the earnings figure at the time, there would have been an increase of about €10.50 in the State pension which would have cost about €132 million extra on top of the budget change of €5 that was made.

Chairman: Then we can extrapolate out from there other social welfare.

Mr. Ciarán Lawler: Yes.

Chairman: Okay. I do not know if the next question is for the Department of Finance, Public Expenditure and Reform or Social Protection. If we had a smoothed earnings approach, is that something the Departments could implement themselves or would they need some sort of oversight body to engage with that process?

Mr. Ciarán Lawler: Again, the Commission on Pensions has endorsed the idea of an oversight body. The advantage to such a body is that it would do the calculation and work out what the benchmark or price increase would result in for the following year. It can also take other factors into account, such as the effectiveness of the benchmark to date, the impact on poverty and any particular economic circumstances that mean we should do something this year, and then make a recommendation to the Government. It would be along the lines of the Low Pay Commission approach. It removes the question a distance from the annual, political approach to the increase that we have at the moment. It would do the calculation and make a recommendation to the Government. If it was departing from the answer, it would give the reasons or the rationale for that.

Chairman: Does the Department of Public Expenditure and Reform agree?

Ms Jasmina Behan: In terms of whether the Departments can implement the indexation, yes. That can be an automatic process. The calculation is relatively straightforward once the parameters are agreed by the Government. However, the issue arises when what the model produces as an indexation or the smoothed earnings result. If we are in those unforeseen circumstances, what happens then? Some discretion is needed for those situations. How that is handled is what is being proposed at the moment. One of the recommendations of the Commission on Pensions is that there is an oversight body. However, as I said in my opening statement, one also needs to consider whether that is adding an additional layer of administration and how costly it would be.

Chairman: I have asked the following question to previous speakers on this topic. I am thinking, in particular, of the issue of prospective or retrospective modelling, whether that is prices or wages. Do we currently gather enough data within our system to have a robust calculation of that? Do we believe we do? As a committee, we get lots of reports from all of the Departments. It seems that a huge amount of data is collected, but is it the right type of data and do we have enough data to make those forecasts or models from previous quarters?

Ms Jasmina Behan: I will respond and perhaps refer to my colleagues from the Department of Finance, who do modelling and forecasting, to speak to that. On the question of whether to backcast or forecast, both approaches have errors. The historical data are usually used as a predictor, so they are typically part of the forecasting anyway. It is also about the fact that if we forecast and use that to calculate the rate, if the forecast proves to be wrong and there is a correction to the individual in terms of their payment, that impacts on the uncertainty. It increases an uncertainty which, I suppose, the indexation benchmark is probably trying to remove. In terms of whether we do, perhaps my colleagues from the Department of Finance might talk about their forecasting.

Mr. Matt McGann: I do not work in the forecasting side either, but I will have a go. The forecast will almost certainly be wrong, because that is the nature of a forecast. We cannot predict the future. That is just one of the trade-offs that one has to live with if one decides to have the indexing based on projections. That can go either way. It could be that the indexation increase is larger than inflation turns out to be. That may cause a problem for the next year. Previous speakers have talked about how some kind of tightening can be introduced the next year to make up for it. There may be a political economy element to that.

Chairman: Yes, it may be politically difficult.

Mr. Matt McGann: The prices stuff is easier. The inflation stuff is easier. As I said, it will definitely still be wrong, but we have a clear harmonised index of consumer prices or consumer price index. We have a clearer metric. The wages are more complicated because there are more possible metrics that could be used. Our own projections for wages tend to be from the very top down, because where we use wage projections is to feed into our macroeconomic forecasts. We are looking at the aggregate level. We use something called compensation of employees. That is basically like the pay bill. It has numbers in it. The number of people at work drives that as well. That is perhaps not as suitable for trying to maintain parity with wages.

Average weekly earnings is used for the benchmark. Average weekly earnings also has data on hours in it, then there are average hourly earnings, and for the average wage, there is full-time and part-time data. The data are there, but the wages one is more complex.

As I mentioned earlier, the wages one is a very timely indicator of the problems that one can have with what are seemingly reliable data. For example, because of the compositional issue that it tended to be lower earners who moved out of employment in 2020, and because those lower earners moved out of employment, the average wage went up. Then there was an increase of something like 19% in average compensation of employees in 2020. It then has to work out the following years when those workers come back in.

Unfortunately, data can still give one problems and things to deal with. In the Irish case it is probably less of an issue in this area, but there can be revisions to the data. Even when one is using historical data, there can be revisions to data. The historical data versus the projection gives one that trade-off whereby perhaps one is indexing to the historical data last year or the year before when we would have perhaps had negative prices, and then there is a sudden change and there are very high prices this year. There is no silver bullet or simple choice on it. A trade-off is being made between different options.

Chairman: When I ask this question, I am very aware that I am talking to representatives from the Departments. I do not mean to put the witnesses in a difficult position, but I want to touch on the issue of whether the indexation should be statutory or in legislation, and the potential advantages and disadvantages of that. I am working on the assumption that there would be get-out or set-aside clauses in it. I am not talking about legislation that could in any way be constrained by that. It is perhaps a larger issue than just this piece on indexation. Obviously, we have talked about well-being budgets in here, which is policy and not statutory. We can see that in other areas of the EU and, for example, in the UK, there is a Well-being of Future Generations (Wales) Act. I am wondering if it is fair to ask the question. From the various Departments' points of view, is there a difference in the implementation of something that is statutory and something that is not?

Mr. Joe Cullen: That is an issue that we referred to in our opening statement as a policy choice for the Government of the day. It would seem to me that if one puts arrangements in legislation, it is very rigid. Before one would go down that path, one would probably need to think carefully through all the other elements of the arrangement and make sure that one has it as good as one can get it before one puts it into legislation. That would suggest to me that perhaps, as a starting position, if one was going down this route, one might go with the non-statutory guidelines approach and suck it and see, as it were, for a period before moving to a statutory set of arrangements, which, as I said, tend to be a little bit more rigid.

Chairman: Is it fair to say that bearing in mind that subsequent Governments could roll back on what are fairly substantial changes to the working methodology of building budgets, if it is working well, in a perfect world it should be statutory? Perhaps Mr. Cullen does not want to commit to an answer.

Mr. Joe Cullen: I think that is a policy choice for the Government of the day. It is possible, with the approval of the Oireachtas, to change legislation, but in practice it can be a cumbersome process, as compared with changing a set of guidelines that are non-statutory. There is no overriding set of principles that state it should be one or the other.

Chairman: I am very aware that Deputy Ryan is waiting to come in. I am nearly finished; I apologise. One of the issues that was touched on in the last session with Mr. Johnson, which we had not touched on in the two previous sessions, was the issue of regulated prices. In the UK, obviously student loans account for a large proportion of that. Other relevant areas include travel, cars, the cost of travel or anything where the UK Government regulates the prices. As we said today, this discussion has been happening for 15 or 20 years. Is that a part of the discussion at the moment?

Mr. Ciarán Lawler: No.

Chairman: Okay. Has the Department of Public Expenditure and Reform not really come across that yet?

Ms Jasmina Behan: No.

Chairman: My final question is for Ms Behan. I was interested that she brought up the HICP. There was a new recommendation, I believe it was in November last year, around including house prices. It currently includes rent and the recommendation was that it would also include the cost of home ownership. I have formed what is perhaps an incorrect opinion over the past three sessions that a lot of the early generation of indexation started off linking it to prices, and the current thinking is that it may be more robust when linked to wages. Given that we are experiencing huge levels of inflation with rental costs and house prices, is the HICP of particular interest? Given Ireland's housing crisis, is the HICP a fair reflection of what is happening within our own system?

Ms Jasmina Behan: I will ask a colleague from the Department of Finance to come in on the HICP piece, but I will try to answer it first. As I mentioned in the opening statement, we moved towards the HICP and away from the CPI. It is more in line with the EU comparison, so there is that international aspect to it. It has always been the case that individual countries' circumstances may not fit neatly into the measurement. There is an even greater complexity around what is measured in each case and what is appropriate to use for indexation of pensions, such as baskets of goods and so on. The view that the HICP may be more appropriate for pensions because it excludes certain elements and might better reflect the basket of goods is one aspect to using that parameter, but other parameters can be used as well. With regard to including house ownership, again the consideration is about who the indexation is trying to protect. For some individuals who do not own, it might be appropriate to use a different parameter, and maybe the HICP is more appropriate. There are pros and cons in using different indices to grow the inflation. Perhaps my colleague Mr. McGann would have greater insight into the HICP.

Mr. Matt McGann: The HICP is an EU-wide indicator. We do not have the ability to change it. It is required for our economic and monetary union participation and Ireland would not have the ability to move that ourselves. The main difference that I can remember, off the top my head, was the exclusion of mortgage interest payments from HICP. I cannot remember much more detail on that but we could provide a note to the committee on the differences between the HICP and the CPI if that would be useful.

Chairman: That would be very useful. I am interested because that change is being recommended. It seems that their modelling of house prices is based on rent, which is difficult in itself. I thank the witnesses for that and any clarity on it would be useful. I will now bring in Deputy Ryan who has been waiting very patiently.

Deputy Patricia Ryan: I thank the Chairman. I apologise for having to step out to speak in the Chamber. I welcome our guests. I was going to ask about the smoothed earnings approach but the Chairman has asked about much of that, and I am thankful for the answers there.

Would the witnesses foresee any technical issues if indexation was to be expanded to all or most social welfare payments and the taxation system? Have the Departments carried out any analysis of indexing social welfare payments, including payments and thresholds, or the taxation system?

Chairman: I believe that is for Mr. Lawler.

Mr. Ciarán Lawler: We discussed this issue a little bit earlier. At the moment the current focus is on State pensions and the smoothed earnings approach, as the Deputy mentioned. There is a commitment in the roadmap for social inclusion to examine a benchmarking and indexation approach for other payments such as working age payments. As we discussed earlier, this brings in an added layer of complexity. For example, people are in different circumstances. Lone parents may have different needs from those of people with disabilities, who also may have different needs from those of jobseekers. There are different rates of payment across the social welfare system for different contingencies. All of that would have to be taken into account. Where would the benchmark be set? Would it be a percentage of earnings or would it be something else? How would it be indexed? Would everybody be indexed in the same way? There is a commitment to look at it and we will start looking at it this year. It does bring in an added layer of complexity, but we will examine it.

Deputy Patricia Ryan: I thank Mr. Lawler for that. That is all, because the other questions I was really interested in were around the smoothed earnings. Those have been answered, so I thank the witnesses. I thank the Chairman.

Chairman: I thank Deputy Ryan, and I apologise once again for keeping you waiting.

Deputy John Lahart: I apologise for my delay. I tried to earwig on some of the contributions.

One of the things that struck me, and perhaps will have struck a lot of people, is the range of commissions, initiatives, groups, reviews, reforms and frameworks that have been put in place over the past 30 years, and even the raft of things that have happened in the last number of years. Some people are terribly well provided for, as the finance officials will know. There are even some semi-State public employees, and I can think of one company in particular, who are regarded as having the Rolls-Royce of pensions. Curiously, that group is making representations to some politicians at the moment about indexation of pensions.

The witnesses may already have covered my question, and if so I ask that they would please forgive my ignorance about it. Because of inflation in the last little while, and due to Covid dampening down so much consumer activity, I have been receiving representations from constituents around issues such as the home adaptation grant, and finding that the amounts available for them have not kept pace with the increased costs of construction. Indexation does not just apply to pensions. It clearly comes into stark relief at particular times.

I have previously raised the theme of future-proofing budgets in the Oireachtas Select Committee on Budgetary Oversight. In the last two years we have begun to equality-proof budgets, so we should also embark on future-proofing budgets, if such a thing is possible, to ensure that spending now does not involve creating an increased burden on generations to come. In the context of indexation, could any of the witnesses speak to that? If we were to future-proof things, where do they see this given the demographics? We hear about the ratio of pensioners to those who are actively involved in participating in the labour market. This ratio will narrow in the coming years and more people will be dependent. Clearly, indexation has implications for that. Perhaps some of the witnesses could speak to that piece, if it has not already been covered. It has been covered, I will get it back in the transcript.

Ms Jasmina Behan: I thank the Deputy. I will start, and my colleagues might want to contribute afterwards. With regard to indexation and benchmarking, the idea is to preserve the real value for people in receipt of the State contributory pension and benchmark against earnings in order to ensure that the rates for pensioners keep pace with the growth in earnings and the real value.

On sustainability for future generations and the impact of demographic changes, the issue has been considered by the Commission on Pensions, which examines a wide range of issues of relevance. These issues include the State pension age, the sustainability of the funding for pensions, and the indexation of rates to preserve the value and keep the pace. These are just some of the issues that were considered by the commission. The Government is considering the recommendations through the Cabinet committee on economic recovery and investment and has referred the questions on sustainability - or meeting funding demands associated with an ageing population and demographic change - and the parameters we might need to put in place to fund that expenditure to the Commission on Taxation and Welfare. All the deliberations will be presented as a proposal to the Government, to be decided on by the end of March. Many of the issues are being considered at present.

Mr. Matt McGann: On the wider point, the Deputy raised an important matter. Previously, colleagues from the ESRI and the Nevin Economic Research Institute pointed out that indexing to wages is fiscally neutral in that the tax–GDP or expenditure–GDP ratio stays the same. However, that is based on all other things being equal in the abstract and there being no other emerging pressures. In fact, we know we have many other emerging pressures, including in respect of how Covid will play out, the structural shifts in the economy, what those shifts will mean and how Brexit will fully play out. We do not know how these will play out. We know we will have to put considerable sums aside to fund the green and digital transitions. We will probably have increased health expenditure as a result of Covid. As the Deputy rightly pointed out, there are demographic changes coming. These are among the better-known knowns. We do not yet have a good handle on some of the factors, such as the digital transition, but we do on the ageing population and demographic pressures. As the Deputy correctly pointed out, going from having four people at work for every pensioner to two will place an unsustainable demand on the system as it stands. Indexation to wages is fiscally neutral in the abstract but, as others have pointed out, there is an argument in favour of maintaining some flexibility because there are many other pressures coming down the line that will eat into our available resources. I am trying not to use the phrase “fiscal space”.

Chairman: Does that answer Deputy Lahart’s question?

Deputy John Lahart: It was stated that the ratio of those in receipt of State pensions to those at work will narrow. On the other hand, we hear that the population is going to rise to 6 million by 2050. This suggests that there will be many births and much immigration, probably for labour reasons. Is it innocent of me to ask whether the figures can be substantiated?

On the unknowns, as the delegates were talking, I was thinking about a move to the cost-rental model, for example. Under this model, people might be in a position for the first time in Ireland to rent for the long term or for life. In theory, they should have more disposable income because they will not be facing the cost of a mortgage, although we know that in some parts of Dublin the cost of a mortgage is half the cost of rent at the moment. However, I am assuming they would have more disposable income. Under the Vienna model and other such models, these people’s rent obligations would taper off on retirement. It would be built in that there would be a tapering-off when their income dropped and they were in receipt of the State pension. Are considerations like these being factored in? These are general questions. I am not pinning them on the delegates because I would imagine they have answered more detailed ones already. I am just doing a more general sweep.

Mr. Matt McGann: On the ageing population, the population will still grow but at a slower rate. The fertility rate is falling and people are living longer. There is a compositional issue in that the proportion of the overall population working by comparison with the proportion not working is changing. That has two effects. First, it affects age-related expenditure because it goes up a lot more. Second, it slows growth because a big input to growth is labour force growth. This is lost when not as many people are coming in. It has been a big driver of growth. As the Deputy correctly pointed out, a big unknown in this regard is migration. Migration can feed into it. That is difficult to forecast. The Department published a paper on population ageing and the public finances last September. We use EUROSTAT projections for the demographics, fertility rate, long-term growth rate in the economy, etc. The increase in age-related expenditure will place a huge burden on the public finances. I would be happy to send on the paper from last September, which goes into a lot of detail on all those aspects.

Deputy John Lahart: What kind of financial burden is there on the State? I do not mean any other kind of burden, such as a psychological burden. What pension entitlements would many of the migrant workers who might have been here over the past 20 years have, or have taken home with them? Are there any figures on that?

What percentage of those who reach retirement age continue to work? It is a while since we have had a census but we might have a better picture this year. Have we any figures on this?

Mr. Ciarán Lawlor: I do not have those data to hand but we will see whether we can get something for the committee. I am not sure whether we have the data on migrants per se, but we will certainly be able to supply to the committee the data on people's effective retirement ages afterwards. I do not have them to hand. There was just one other point. It comes back to the issue the Deputy raised on the sustainability of expenditure given the demographics. The Department of Social Protection produces, as a legislative requirement, an actuarial review of the Social Insurance Fund every five years. That looks at projections decades ahead. It looks, for instance, at various assumptions around migration, fertility, economic growth and mortality. That will be published towards the end of the year. That will give us another set of projections with more up-to-date data on the long-term impact of population ageing.

Deputy John Lahart: I will finish on this unless the Chair wants to give me a little more latitude. What particular inputs would the Departments of Social Protection and Finance like to see in this year's census? What kind of information would Mr. Lawler be looking out for or like to see harvested that would help the Department?

Chairman: I am afraid that is another question for Mr. Lawler.

Mr. Ciarán Lawler: For clarity, does the Deputy mean helping us for a particular purpose?

Deputy John Lahart: The census asks a range of questions and that feeds into the kind of models that the Department of Social Protection builds. What kind of additional questions or what kind of focus would assist the Department in planning for the future? What kind of things that we might not have seen in a census questionnaire previously would Mr. Lawler like to see in it that would assist the Department in future planning?

Mr. Ciarán Lawler: Ms Behan wants to come in on that question.

Ms Jasmina Behan: I might come in. The census provides us with a lot of information, in terms of questions in variables that are there, that we need for modelling. The issue is that the census is every five years and a lot of the data for modelling in terms of demographics we need every year. Those are typically done as estimates using the labour force survey. It would be great if we had a census every year but, of course, we cannot have it every year. It is not so much what is in the census in terms of questions; it is that the census is every five years. For us to do demographic modelling, that level of frequency causes issues and we have make estimates, as I said, using the labour force survey.

Deputy John Lahart: May I ask one final question, Chairman?

Chairman: Yes.

Deputy John Lahart: It is the on funding. The former Minister for Finance, Mr. McCreevy, established the National Pensions Reserve Fund, NPRF. There was €20 billion or €22 billion in that when it came to the crash and it possibly softened the blow. However, it is empty. I believe in a rainy day fund and I believe in that future-proofing of public finances. Is there a scenario in an ideal world where, if a prudent future-proofing approach was taken to issues, for example, corporation tax where we have been told for the past five or six years at the committee that we cannot rely on it and we should put aside surpluses from it, and we started managing that, that this would not become the crisis that we think it could become? If we took a mature approach to this, will the State be well provided for in meeting the demands of pensions into the future or will it be challenging no matter what model we come up with?

Chairman: Who would like to take that?

Ms Jasmina Behan: I can start by referencing the work of the pensions commission, which has tried to look at this issue of sustainability and putting the funding for demographic changes ahead of us and the associated expenditure pressures on a footing that would ensure that funding is there. The commission has offered a range of options of how that can be achieved looking at different elements that could contribute to that sustainability, which range from the PRSI changes, the pensions age and the concept of a permanent Exchequer contribution. Those options of how the funding might be secured to ensure sustainability is there for the future of the pensions system are now under consideration by the Commission on Taxation and Welfare.

Mr. Matt McGann: It is important to point out how the rainy day fund was designed. It was not with the intention of necessarily funding future pension liabilities, as the NPRF was. It is more as a stabilisation function for potential future crashes or unusual events.

In terms of the corporation tax receipts, the Department has consistently said that we need to be careful about what we do with what are potentially windfall receipts and allow them to feed into the expenditure base. We had an unhappy experience in the 2000s when we allowed taxes that were not structurally permanent to feed into the expenditure base.

Deputy John Lahart: Am I correct that all State pension payments come from current resources and there is no reserve fund specifically for it?

Mr. Ciarán Lawler: The State pension contributory payments, which are the vast majority of pension payments from the Department, are funded through the Social Insurance Fund. When that fund is in surplus, State pension contributory payments are made from that surplus, and when it is not in surplus or when it is in deficit, it is subvented by the Exchequer. For the vast majority of its life, in fact, it has been in deficit. We have had periods where we have built up fairly large surpluses of more than €3 billion and €4 billion, but when we hit an economic crash such as we had or have the experience of Covid, it can be exhausted very quickly. That is how it operates.

Chairman: I thank the Deputy. I do not see any other Deputies with their hands raised and we are coming towards the end of the session.

I thank all the officials for attending today and for the evidence provided to the committee. It has been a fascinating session. The committee has now concluded its public meetings on indexation. We hope to publish a report on this issue in the near future and we will provide the Departments present with a copy of that report. I again thank the officials for their time and expertise.

There is no public session scheduled for next week but it is proposed that the committee meet in private session next Wednesday, 23 February, at 5 p.m.

The select committee adjourned at 7.19 p.m. *sine die*.