Briefing Paper: Loss of State Pension Spending Power in 2022 Due to Inflation

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Age Action is Ireland's leading advocacy organisation on ageing and older people. Age Action works for a society that enables all older people to participate and to live full, independent lives.

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Executive Summary

It is longstanding Government policy that the State Pension is the "bedrock" of income in older age, and with the current storm of inflation hitting Ireland it is essential that Budget 2023 protects older persons who do not have the means to cope with the rapid erosion of their spending power. This briefing document summarises the main facts and lays out the case for raising the State Pension in Budget 2023.

- Age Action is making a conservative assumption that inflation will be 9.8% for older persons in the period January 2022-December 2022, given that they actually experienced this level of inflation in the period June 2021-June 2022. This is a level of inflation not seen since the 1980s.
- Based on 9.8% inflation, one euro in January 2022 will have the spending power of €0.91 by December, and it will further lose spending power in 2023.
- By December 2022, the full rate contributory **State Pension will have lost at least €22.61 per week** in spending power.
- Over the course of 2022, someone on the full rate contributory State Pension of €253.30 will face **a cumulative €589.48 loss of spending power**. This represents lost consumption of goods and services for them personally equivalent to half a tank of home heating oil or a month's groceries. It also represents lost demand in the economy.
- For a couple, where one is a qualified adult and the other receives the full contributory State Pension, their joint loss of spending power adds up to €1,118 between January and December 2022.
- In all cases, it is important to realise that the loss accumulates over the year, as inflation keeps growing month after month. This means that most people only experienced a quarter of the year's loss of spending power by end-June, but they will experience much greater loss of spending power in the second half of the year. This is worsened by the need for heating and light as winter arrives. (The cumulative loss of spending power is illustrated below.) **There is a strong argument for raising the State Pension and other core welfare from Budget Day, rather than waiting for January 2023.**
- Many private and occupational pension funds will not increase pension rates or will not raise them as much as inflation, which will reduce the spending power of many older persons. Based on average incomes and savings from CSO surveys, the average older person living alone will lose €1,532 in spending power by end-2022 and the average older couple will lose €3,364.
- Those who have cash savings are seeing their spending power decrease rapidly, and most investment returns are not keeping up with inflation. For example, cash savings of €1,000 in January 2022 will have the spending power of €911 in December 2022, and interest rates are providing little or no compensation for this erosion of spending power.
- Even if energy prices go down in 2023, prices across the economy will settle at the "new normal", which means that those on fixed incomes will be locked into a lower standard of living unless remedial action is taken to raise their incomes.

- In the UK and most EU countries, social welfare rates including pensions are indexed to inflation and/or average earnings. That means that the rate of pensions in those countries rises automatically to keep pace with rising costs. In the UK, pensions are expected to go up £18.50 in 2023 [€22.36].
- Age Action is calling on the Government to raise the full rate contributory State Pension by **at least €23 in Budget 2023**. Anything less than an increase of the State Pension by €23 is a cut in real terms that will increase poverty and deprivation among many older persons.
- A nominal increase of €10 on the State Pension in Budget 2023 would represent a cut in real terms, as the **spending power** of a State Pension of €263.30 in January 2023 would still be €13.50 lower than in January 2022. **Between January 2022 and December 2023, a person on the full rate State Pension will lose €1,487 in spending power, if they only receive a €10 increase in 2023**.
- Raising the State Pension by €23 will cost less than €800 million at a time when tax and PRSI receipts have soared by over €5 billion just halfway through 2022. Raising **all** core social protection incomes (not just pensions) by at least €20 will cost less than €1.5 billion. This is affordable, just and necessary.
- Budget 2023 is not constrained by a lack of resources. The state's fiscal position is robust, with a projected surplus in public spending with lower social protection spending post-COVID-19 and billions of additional revenue from tax and PRSI. The Government has the necessary resources available to invest in housing, healthcare and other long-term issues, while also protecting everyone who relies on the state for their core income alongside super-targeted measures for those with acute needs, such as older persons living alone in poorly insulated housing.
- **Anything less than an increase of the State Pension by €23 will be a political choice to cut the living standards of those on fixed incomes, not an economic necessity.**

Lost Spending Power of the State Pension

*The nominal value of the State Pension is less important than its **spending power**, which is the amount of goods and services that it permits older persons to afford.*

In January 2022, the full rate of the contributory State Pension was €253.30. Older persons experienced price inflation of 9.8% in the period June 2021-June 2022, according to the CSO.[1] Age Action is making a conservative estimate that older persons will face inflation of at least 9.8% in the period January 2022-December 2022. This seems likely given that inflation has grown at a faster rate in 2022 than it did in 2021. For comparison, the Minimum Essential Budget Standards Research Centre estimates that the cost of a Minimum Essential Standard of Living will rise by 11% in 2022.[2] It is also a fact that the loss of spending power projected here for the calendar year 2022 already occurred in the period June 2021 to June 2022, which shows the pressure on older persons' financial wellbeing.

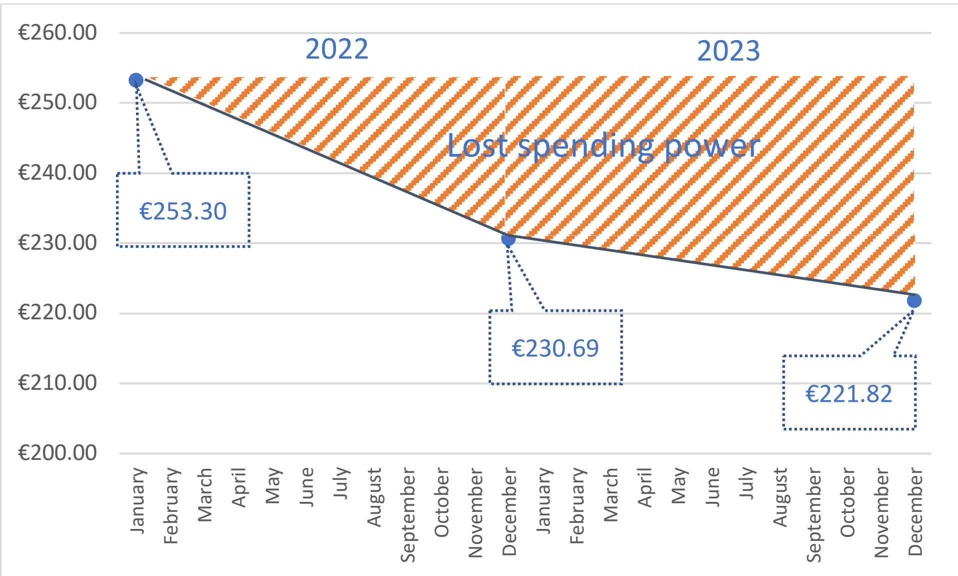
Based on 9.8% inflation in 2022, the rise of prices means that by end-December 2022 people will experience a loss of nearly €23 (€22.61) in the weekly spending power of the full rate contributory State Pension.

Assuming a steady rise of inflation throughout the year, the cumulative loss of spending power in 2022 will be €589.48. That is, older persons reliant on the State Pension as their core income will have €589.48 less to spend throughout 2022, which for many people means cutting back on home heating, groceries or other essentials.

The ESRI projects inflation of 4% in 2023.[3] Assuming no change in the rate of the State Pension, this would result in an additional loss of €8.87 per week in the State Pension by the end of 2023, on top of the loss of €22.61 by end-2022. This means that during 2023, the top rate State Pension would lose a cumulative €1,410.21 in spending power if it is not raised in Budget 2023.

The loss of spending power in 2022 and 2023 combined would be just under €2,000 (€1,999.68) if Budget 2023 does not increase the rate of the State Pension.

*Figure 1. Projected **spending power** of the full rate contributory State Pension January 2022 to December 2023*



Note: the red crossed out area represents the cumulative loss of spending power on a weekly basis.

To avoid people experiencing the cumulative loss of spending power towards the end of 2022, **there is a strong argument for raising the State Pension and other core welfare from Budget Day, rather than waiting for January 2023**.

Why a €10 Increase to the State Pension is Not Enough

As outlined above, the full rate contributory State Pension will lose €22.61 in spending power by the end of 2022.

If Budget 2023 increases the State Pension by €10, the new nominal rate would be €263.20, but the **spending power** of the top rate State Pension would still be only €239.80 compared to January 2022, which is a loss of €13.50 per week in real terms (i.e. in a person’s ability to buy goods and services that are now more expensive). Putting it another way, €10 in January 2023 will have the spending power of €9.11 compared to a tenner in January 2022. That €9.11 does not fully compensate for the loss of €22.61 in spending power by December 2022 (€22.61 - €9.11 = €13.50).

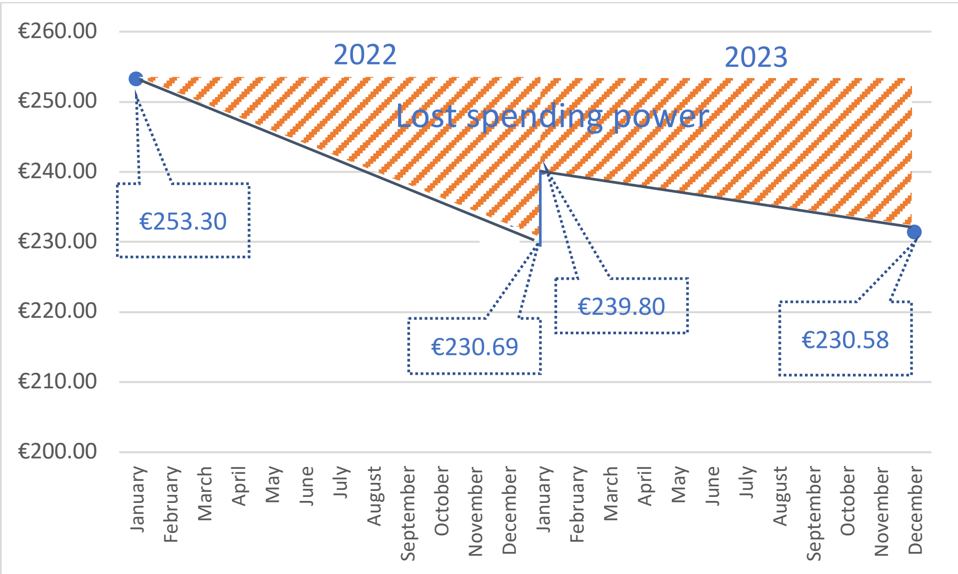
Even with a nominal €10 increase, the full rate contributory State Pension would have its spending power reduced by €657.52 throughout 2023 *before taking account of further inflation*.

The projection of 4% inflation in 2023 would reduce the spending power of the uplifted State Pension by €9.22/week by end-December 2023, a cumulative loss of €240.46.

The total loss of spending power by December 2023 despite a €10 increase, relative to the January 2023 rate's spending power, would be nearly €900 (€897.98).

When the loss of spending power in 2022 and 2023 are combined, despite a €10 increase in January 2023, the total loss of spending power across both years would be €1,487.46.

*Figure 2 Projected **spending power** of the full rate contributory State Pension January 2022 to December 2023 with nominal €10 increase (real increase of €9.11) from January 2023*



Note: the red crossed out area represents the cumulative loss of spending power on a weekly basis.

Most of the impact of inflation will be felt in the second half of 2022 and into 2023. Around 25% of the impact occurred in January to June, with 75% to occur in July to December 2022, because of the cumulative nature of the "wedge" of lost income (as illustrated above).

SILC found that half of older persons (65+) living alone have an annual disposable income of less than €18,131 (less than €347.72 per week). In many cases, the State Pension may be a person's only income. And it is important to recall that only two-thirds of older persons get a full rate State Pension.[4]

As an example, a single person who relies on the State Pension as their main income is set to lose €589.48 of spending power in 2022. That amount of money represents well over two weeks of pension. It is the amount needed for half a tank of home heating oil.

Alternatively, it could represent the cost of a month's groceries. Many people will simply be unable to afford these costs and will have no means to increase their incomes. As a result, they will go without essentials like heating or nutritious food, as well as avoiding transport costs or even some medical costs due to income inadequacy.

Before the current period of inflation, SILC found that nearly one in eight (11.9%) older persons was at risk of poverty, one in eleven (8.4%) suffered deprivation and one in 25 (2.5%) lived in consistent poverty. The consistent poverty rate was up by 250% from the previous year. These figures are from 2021 and before the recent spike in living costs. These poverty indicators are considerably worse for older persons living alone, of whom 21.5% were at risk of poverty, 12.1% suffered deprivation and 4.3% lived in consistent poverty, with women typically affected more than men.

Loss of Other Income and Savings

Overall, there is a risk that older persons are at of risk falling behind in their living standards because most of them are unable to replace income or savings lost to inflation.

Many private and occupational pension incomes will not keep track with inflation. There is a lack of data available on how many occupational pensions and other private pensions (such as annuities) will grow with inflation. Even when pensions are indexed to inflation, there is often an annual cap on how much they will grow. Many pension schemes have not increased the rate of their pensions in years, including the pension schemes of semi-state companies.

Cash savings are often on near-zero interest rates and any increase in ECB interest rates will take time to affect deposit rates and will be far below the rate of inflation. For example, assuming near-zero interest, pension savings of €1,000 in January 2022 will have the spending power of €911 in December 2022. **If high inflation continues into 2023, some people could see 15-20% of their retirement savings wiped out in just two years**.

As an example of an older person who has above average living conditions, a single person with an occupational pension of €300/week that is not inflation-linked is set to lose €698 of spending power in 2022. If the same person had €10,000 in cash savings, their savings will lose €893 of spending power. In combination with the €589 lost in the spending power of the State Pension (assuming a maximum rate), a person in these circumstances will lose a combined €2,180 in 2022 alone,[5] and they will experience a further loss of spending power in 2023. The loss will be higher for couples. Even in nominally comfortable households, the combination of these factors is going to lead many older persons to have to make significant cutbacks on their expenses, and some people will find it difficult to makes ends meet.

Based on average incomes and savings from CSO surveys, the average older person living alone will lose €1,532 in spending power by end-2022 and the average older couple will lose €3,364.

There will be no short-term solution to ensuring a higher return on savings as interest rates on deposits are still at a historical low point. Likewise, pensioners may not have much ability to gain a higher income from an occupational pension scheme if there is no provision for it to rise with inflation. And even those schemes with an inflation component often have an annual cap in how much an income will rise.

Practically all older persons benefit from the State Pension and maintaining the spending power of the pension is the clearest option for the state to support older persons who are losing spending power from private pensions and savings, as well as helping those for whom the State Pension is their main or only source of income.

Older persons are facing a major assault on their incomes, savings and living standards. In this context, it is imperative that the State Pension goes up at least €23 as the bedrock of income support.

Targeting versus "Universal" Measures

One working paper from the IMF discusses fully compensating the households on the bottom 20-40% of incomes to protect them from the surge in living costs. They describe the "compelling" case for supporting lower-income households to prevent energy poverty, but caution against economy-wide measures.[6]

While the improvements to the supplementary welfare allowance are very welcome and helpful, the newly named Additional Needs Payment (ANP) must continue to be seen as exceptional rather than a means of correcting for inadequate core incomes. Having a sufficient income to meet physical, social and psychological needs gives a person choice and control in their lives and allows them to be a fully functioning member of society.

Core social protection payments are targeted measures; they go to those who need income support because they cannot work due to disability, mandatory retirement, frailty, care duties or inability to find a job. Increasing all core social protection rates by €20 and increasing the top rate State Pension by €23 would cost up to approximately €1.5 billion in a full year based on the Parliamentary Budget Office's latest ready reckoner.[7] This compares with a tax take that is up over €5 billion by end-July, not including higher PRSI revenue. Even if Corporation Tax receipts are excluded as one-off, the state has the capacity to protect the incomes of those who rely on social protection for their core income.

It is important to recall that some social protection incomes (including the contributory State Pension) are taxed, that most of the money is spent in the local economy (driving aggregate demand) and that it is subject to consumption taxes like VAT. The net cost of raising social protection incomes is considerably lower than the gross/nominal cost, unlike some other public spending measures.

In contrast, reducing excise on fossil fuels or the €200 electricity subsidy to most households are universal measures that provide benefits to those who don't need them as well as to those on lower incomes. These type of measures are poorly targeted and expensive. Some of the poorest households don't receive the full amount (e.g. those on shared meters and some renters). Some older persons now have a surplus on their electricity accounts, but they still can't afford home heating oil for the winter. The €200 electricity subsidy cost nearly €400 million, whereas raising the State Pension by €23/week would cost less than €800 million and do much more to prevent poverty.

For example, an older person on the State Pension in receipt of the €200 payment will still lose more than €389 in spending power in 2022.[8] In addition, private and occupational pensions may not rise at all, and any cash savings will now be nearly 10% less in spending power. It is clearly much more important to raise the core State Pension rate than universal one-off payments to all households in the country.

There certainly is scope to bring in super-targeted measures in addition to raising core social protection incomes. For example, Age Action has called for an Energy Guarantee for older persons that would provide a variable cash payment to help people cope with the rising price of energy.[9] Likewise, increasing the Living Alone payment would target those at greater risk of poverty and deprivation. But given the healthy state of the public finances, there is no need for any trade-offs between targeting social protection core incomes and super-targeted measures to reduce poverty. The state has the capacity to afford all these measures and more, based on the additional revenue already in from income tax, PRSI and VAT.

Benchmarking and Indexation of the State Pension is Essential and Urgently Required

In the UK and many European countries, social protection incomes like pensions are automatically increased in line with inflation and average earnings through indexation. In the UK, this is called the "triple lock", where pensions are raised by at least 2.5% if either inflation or average earnings are growing to a lesser extent. Despite the high level of inflation experienced in the UK like in Ireland, the triple lock will be implemented in 2023,[10] which means that pensions there are expected to rise by 10% or £18.50 [€22.36].[11]

The indexation of social protection payment is an "automatic stabiliser" in any economy affected by inflation, as it keeps up people's spending power, much of which goes into shops and services in their local areas. Indexing social protection rates is one way that European societies reduce boom-and-bust in their economies.

As recommended by the Pensions Commission, a process of benchmarking and indexing the State Pension is essential to preserve its spending power. The adoption and implementation of this recommendation by Government is urgently required. However, the Pensions Commission report cautions that a benchmark of 34% of average earnings may not be sufficient to prevent poverty, which is why Age Action has called for a comprehensive Cost of Aging study to be commissioned to provide the evidence for a robust benchmark for the income adequacy of the State Pension.

Age Action is calling for a €23 increase on the maximum contributory State Pension rate, €22 on the maximum rate non-contributory State Pension, and €15 on Qualified Adult increase. We are also calling for €15 on the Living Alone increase and the introduction of a new Energy Guarantee for Older Persons to help with energy costs. The Government should make these increases directly after Budget 2023.

Given the very significant rise in revenue from tax and social insurance, due in part to inflation, **a Government decision to raise social welfare incomes by less than the rate of inflation will be a political choice to cut the living standards of those on fixed incomes, not an economic necessity.**

References

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[2] Minimum Essential Budget Standards Research Centre (June 2022) MESL Pre-Budget 2023 https://www.budgeting.ie/download/pdf/vpsj_mesl_pre-budget_2023_submission.pdf

[3] ESRI (June 2022) *Quarterly Economic Commentary Summer 2022* https://www.esri.ie/publications/quarterly-economic-commentary-summer-2022
The 4% inflation projection seems on the low end of what is likely and more recent analysis for the Eurozone suggests that inflation will continue to be high throughout 2022 and into 2023.

[4] Department of Social Protection figures given to Age Action.

[5] The loss of spending power in a person's State Pension income and occupational/private pension income will occur throughout the year, accumulating over time, whereas the loss of savings' spending power is calculated at year-end comparing the nominal amount with its lower spending power.

[6] Ari et al (2022) *Surging Energy Prices in Europe in the Aftermath of War: How to Support the Vulnerable and Speed up the Transition Away from Fossil Fuels.* https://www.imf.org/en/Publications/WP/Issues/2022/07/28/Surging-Energy-Prices-in-Europe-in-the-Aftermath-of-the-War-How-to-Support-the-Vulnerable-521457

[7] Parliamentary Budget Office, *Pre-Budget 2022 Ready Reckoner* https://data.oireachtas.ie/ie/oireachtas/parliamentaryBudgetOffice/2021/2021-10-08_pre-budget-2022-ready-reckoner_en.pdf

[8] That is, the loss of €589 in the State Pension's spending power will be offset by €200, leaving a net loss of €389.

[9] Age Action (2022) *An Energy Guarantee for Older Persons: Policy Brief* https://www.ageaction.ie/sites/default/files/age_action_energy_guarantee_for_older_persons.pdf

[10] Chancellor of the Exchequer (2022) *Cost of Living Support*. Speech. https://www.gov.uk/government/speeches/cost-of-living-support

[11] Financial Times (FT) Adviser (2022) 'Sunak confirms return of triple lock next year'. https://www.ftadviser.com/pensions/2022/05/26/sunak-confirms-return-of-triple-lock-next-year/