Submission to the Department of Social Protection on the 'Smoothed Earnings' Benchmark

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

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Context

- Government agreed in September 2022 that “a smoothed earnings method to calculating a benchmarked/indexed rate of State Pension payments will be introduced as an input to the annual budget process and to be submitted to Government in September each year from 2023.” Officials in DSP are working to prepare a paper for Government in this regard.
- Government have also committed to examining benchmarking in the context of working age payments. Specifically, the Roadmap for Social Inclusion 2020-2025 commits the Department of Social Protection to “Consider and prepare a report for Government on the potential application of the benchmarking approach to other welfare payments.”

Questions Provided by the Department of Social Protection

1. What is the rationale for the introduction of benchmarking for working age payments? What should the scope of the benchmarking be?
2. The Department has proposed use of the “Smoothed Earnings” approach (as set out in the Pensions Commission material) for Pensions scheme benchmarking – would this be appropriate for Working Age schemes? If not, what alternative would you recommend?
3. A possible model for implementation of such a benchmark would be to use it to establish the rate of Supplementary Welfare Allowance, with other schemes maintaining existing relativities. What are your views on this model? Are there alternatives?
4. Are there other arguments that could be made for or against the introduction of a benchmarking in this context?
5. What are the risks (including fiscal, labour market, social inclusion, equity) that need to be considered in introducing benchmarking for working age schemes? How can any potential risks be mitigated?
6. If there are additional costs anticipated, do you agree that social insurance rates, for employees and employers, should be increased to cover the additional costs to the Social Insurance Fund (SIF) or the Exchequer (which is the residual financier of the SIF) that may arise as a result of the introduction of a benchmarking approach for working age schemes?

1. What is the rationale for the introduction of benchmarking for working age payments? What should the scope of the benchmarking be?

The rationale for the benchmarking of social protection payments includes:

- Social inclusion—those who rely on social protection (such as due to disability, illness, maternity, care duties or inability of find suitable work) should be able to afford what society regards as a minimum essential standard of living.[1]
- Economic efficiency—by providing everyone with enough of an income to meet their needs, the potential of the economy is maximised. When people have insufficient incomes, they will go without (as shown, for example, in the deprivation statistics collected by the CSO).[2] Deprivation typically represents permanently lost demand from the economy, and widespread deprivation lowers economic output and leads to job losses and business closures.
- Job creation—while many analysts focus on the role of employment to move people out of poverty, there is a need to also look at the role of aggregate demand (including the incomes of people who rely on social protection) in the creation of jobs. With 1.5 million weekly recipients of a social protection payment, a €10 weekly increase adds up to over €780 million/year extra demand in the economy, enough to support thousands of extra jobs.
- Reduction of political heat—people do not like their already frugal standard of living to be a 'political football' in an annual debate about whether the government will grant them an increase in their weekly incomes. An evidence-based benchmarking and indexation of core weekly social protection rates would allow for automatic adjustments to weekly rates in line with changes in the wider economy. The Low Pay Commission or a similar body could be tasked with recommending increases to core welfare rates as economic data changes.
- Security—people who rely on weekly social protection payments often find it difficult to plan long-term, because they do not have income security especially when there is high price inflation. Even small cost commitments, such as attending a training programme (including travel and subsistence) can become unaffordable if weekly welfare rates are not kept up with the cost of living. People should not have to apply for Additional Needs Payments every time they wish to do anything. Higher and more predictable social protection incomes give people more capacity to plan and organise their lives.

[1] See, for example, www.budgeting.ie

[2] https://www.cso.ie/en/releasesandpublications/ep/p-pihs/povertyindicatorsbyhealthstatus-surveyonincomeandlivingconditionssilc2022/deprivation/#:~:text=Deprivation%20Items&text=In%20November%202022%2C%20the%20CSO,by%20demographic%20and%20other%20characteristics.

2. The Department has proposed use of the "Smoothed Earnings" approach (as set out in the Pensions Commission material) for Pensions scheme benchmarking – would this be appropriate for Working Age schemes? If not, what alternative would you recommend?

It would be inefficient and inequitable to develop an alternative model of benchmarking for different types of social protection payment.

The 'smoothed earnings' approach rightly prioritises benchmarking and indexation against earnings, as people on social protection are likely to fall behind the living standards of the rest of society decline in the long-term if weekly payments are only matched against price inflation.

A common concern, for both the State Pension and other weekly social protection payments, is that the 34% might fall too short. The Report of the Commission on Pensions warns that the 34% benchmark might not prevent households from poverty. Nonetheless, the provision of a strong bottom tier social protection rate provides a 'bedrock' of income protection and the principle of a strong bottom tier should be maintained.

3. A possible model for implementation of such a benchmark would be to use it to establish the rate of Supplementary Welfare Allowance, with other schemes maintaining existing relativities. What are your views on this model? Are there alternatives?

Based on DSP's summary of Budget 2023 measures, weekly social protection rates vary from €218 (SWA) to €262 (Maternity / Paternity / Adoptive / Parents Benefit), not including State Pension or other over-66 rates.[3] As such, it is established practice for the state to pay different weekly rates under different schemes. However it is not established that there is an evidence-based rationale for these differences. For example, why is Disablement Benefit up to €251 (and recipients can also work) whereas Invalidity Pension is only up to €225.50 (and recipients cannot work)? In the context of Equality Budgeting, the rationale for these differences should be re-examined.

The question presupposes that the range of payments is fixed, whereas a review of the adequacy of different schemes is likely to point towards a need to change the relative rate between some of them. For example, higher poverty levels among people with disabilities or among people parenting alone would warrant higher payments.

The question also conflates two separate issues. If the decision is taken to benchmarking using a 'smoothed earnings' approach (i.e. benchmarking against

[3] https://assets.gov.ie/201552/2e76947c-bb9c-4b28-b462-ed692a77a876.pdf

earnings, modified by inflation), that could apply to all payments. A separate policy question is whether all rates should be set at the same percentage of average earnings. For example, it is proposed to set the maximum rate of the contributory State Pension at 34% of average earnings. What percentage of average earnings would be proposed for SWA?

A way forward on this question would be to test the adequacy of different benchmarks, by reference to the MESL research,[4] the Cost of Disability Report,[5] and other relevant data (such as on housing costs and healthcare cost not included in MESL). The lowest weekly welfare rate (in this case SWA) must still be adequate to allow someone to meet an acceptable standard of living.

4. Are there other arguments that could be made for or against the introduction of a benchmarking in this context?

The arguments against benchmarking of 'working age' social protection payments are allied to arguments against welfare or for the minimalization of welfare.

The history of social policy in Ireland from the 17th to the early 20th century involves an enduring theme of dividing social protection recipients into 'deserving' and 'undeserving'. For example, "During this period charitable efforts stand out, but only for categories of the 'deserving poor', principally children and the sick poor. State intervention was minimal, and strongly linked to the control and punishment of the 'undeserving poor'."[6]

Irish social protection continues to be shaped by this logic:

- Means testing is used to minimize the 'cost' of social welfare, rather than to ensure that the income of recipients is adequate.
- Adequacy tends to be examined with respect of full rate payments, ignoring that many people with incomplete social insurance records only receive partial payments.
- People are expected to spend down their cash savings before becoming entitled to higher (or any) weekly cash payments, which reduces their future financial resilience.
- Differences in rates are used to signal that some social protection recipients are more 'deserving' than others. For example, widows and people with a disability tend to receive higher rates than jobseekers. Social insurance (contributory) social protection rates are set a few euro higher than means-tested non-contributory rates, despite households in each case facing similar costs.

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[4] www.budgeting.ie
[5] https://www.gov.ie/en/publication/1d84e-the-cost-of-disability-in-ireland-research-report/
[6] Chapter 1 of Dukelow F and Considine M (2017) *Irish Social Policy: A Critical Introduction*. Second Edition.

An evidence-based approach to benchmarking is an opportunity to reset the logic of social protection rates in a decisive move away from welfare's prejudicial historical roots.

An alternative argument against benchmarking is that social protection rates should be solely or mostly earnings-related. While DSP is still developing proposals on this, earnings-related payments should only ever be a top-up to a basic rate of social protection that is adequate for people to meet a socially acceptable standard of living. It is a failure of some European welfare models that they prioritise earnings-related payments over ensuring the adequacy of the basic rate, and Ireland should not repeat that failing.

5. What are the risks (including fiscal, labour market, social inclusion, equity) that need to be considered in introducing benchmarking for working age schemes? How can any potential risks be mitigated?

Fiscal risks in relation to social protection have been grossly exaggerated. Nonetheless, a robust and diverse tax base (including social insurance) is essential for the provision of adequate social protection, as both the Commission on Pensions and the Commission on Taxation and Welfare have pointed out.

Labour market risks are likewise largely theoretical rather than real. The incentive/disincentive argument is weakly supported by psychological evidence and is, at least in part, ideological rather than technical, and therefore inappropriate for the design of a public service.[7] Almost everyone out of 600,000+ people in receipt of €350 PUP went back to work, some of them into jobs that paid them only marginally more in net income. There was clearly little disincentive to do so.

Job matching (matching people's capabilities with appropriate jobs) is far more important than marginal delays returning to work as the benefits to people and the economy from good job matching are much higher than the cost of a few week's welfare payment that may be necessary for a person to find an appropriate job, rather than accepting the first offer made to them regardless of fit.

[7] For a development of this argument, see for example, Wright, S. (2012). 'Welfare-to-work, Agency and Personal Responsibility'. *Journal of Social Policy*, 41(2), 309-328. doi:10.1017/S0047279411001000, and Schroeder, D. (2000). *Work Incentives and Welfare Provision: The 'Pathological' Theory of Unemployment*, Routledge. https://doi.org/10.4324/9781315201948

6. If there are additional costs anticipated, do you agree that social insurance rates, for employees and employers, should be increased to cover the additional costs to the Social Insurance Fund (SIF) or the Exchequer (which is the residual financier of the SIF) that may arise as a result of the introduction of a benchmarking approach for working age schemes?

Yes.

Overall public spending and public spending on social protection are both atypically low in Ireland compared to western Europe and most of the rest of the EU.

Overall Irish public spending is lower than the EU average.

- In 2021, measured as a percentage of GDP, Irish public spending was the lowest in the whole EU at 24.8%.
- When the figure of GNI* is used instead to remove distortions caused by multinational activity,[8] Ireland's public spending was 45.5% of GNI*, the lowest level of public spending in western Europe (excluding Luxembourg, whose GDP figures are similarly distorted) and ranked 18th out of the 27 EU member states.
- The level of public spending across the EU was 51.4%, and the highest level of public spending was in France, at 59% of GDP.

Irish public spending on social protection is the lowest in western Europe.

- Irish public spending on social protection (as a percentage of GNI*) is ranked 17th in the EU at 16%. As a percentage of GDP it is the lowest at 8.7%.
- The average across the EU was 20.5%.
- The highest level of spending was 24.8% in France.

Even allowing for low unemployment and a relatively young population, spending on Irish social protection is low.

When spending on social protection is adjusted for inflation, the €23.9 billion allocation to social protection in 2023 had the same spending power as €20.5 billion in 2019, lower in real terms than the actual social protection allocation of €20.8 billion in 2019.[9]

The Commission on Pensions and the Commission on Taxation and Welfare have both unambiguously set out the necessity to raise tax or social insurance to meet the needs of our ageing population and to provide an adequate social protection system.

IBEC has acknowledged that "rates of Pay Related Social Insurance (PRSI) will have to increase for both employers and employees over the coming decades in order to offset the increased costs of an ageing population."[10]

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[8] GNI* in 2021 was €230.7 billion, which represented 54.5% of GDP of €423.5 billion.
[9] €23.9 billion multiplied by 0.8562 to reflect cumulative inflation in the period 2019-2023.
[10] https://www.ibec.ie/-/media/documents/media-press-release/ibec---pensions-commission-submission.pdf