The Public Service Pension Levy: Is it Fair?

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In the current economic crisis reducing state expenditures would add to unemployment. The State needs to find additional revenues to fund increasing social welfare payments due to rising unemployment and to support enterprises to preserve/create jobs. The fall in tax receipts can to some extent be met by additional borrowing as in other EU countries, but the State also needs alternative sources of revenue. The Social Partnership process delivered a major success in securing agreement on a framework document including an agreement that €2 billion needed to be reduced from this years borrowing. However this consensus was broken by ruling out immediate tax increases resulting in the bulk of ‘savings’ being sought from public sector pay reductions. In the absence of an agreement ‘savings’ were instead to come via a levy on all public sector workers described as a ‘pensions levy’. The details of the scope of this levy have now been published in the ‘Financial Emergency Measures in the Public Interest Bill 2009’. Apart from confirming the level of the levy the Bill also clarifies who is subject to the levy by specifically excluding 20 different bodies such as the Dublin Airport Authority.

It could be considered that the ‘pensions levy’ is in effect a ‘pay cut’, but it has been presented as a contribution to the cost of public sector pensions, in particular given the disparity that now exists between the security and level of payment between public and private sector pensions. In that context the proposed pensions levy is a considerable change to public sector pensions, and one that was not subject to any considerable analysis or debate, by the Public Service Benchmarking Body or others.

Indeed it could be argued that the Government has already taken account of the greater value of the employer contribution to public sector pensions in discounting public service salaries by 12% following a detailed analysis of the employer cost of public and private sector pensions and implementation of the recommendations in the second benchmarking report in 2007.

By imposing a uniform pension levy across the public sector the Government has inadvertently highlighted three areas of inequality in public sector pensions:

(1) Because the levy was made tax deductible the percentage of income that many low earners pay after tax relief on the levy will be higher than the percentage middle income workers will pay and the tax relief on the levy will generally increase as income increases;

(2) Currently public sector workers earning the same income, may pay different amounts towards their pension, and/or may have different pension benefits such as added years. The levy does not address these issues. In addition imposing a levy across all employees results in considerable transfers across age groups. An employee retiring in February this year, will not have made any contribution via the levy, an employee

retiring in subsequent years will have done so, in particular if a levy were to remain in future years.

(3) There is the low pay issue. Those in receipt of social welfare pensions on low incomes may not qualify or may qualify for only a small part of an occupational pension, even though they have made the required contributions. This inequality is compounded by the tax deductible nature of the levy and different tax rates.

The chart compares the gross and net levy as a percentage of income for a single person paying full PRSI over the income range from €15,000 to €300,000. It shows that the effect of the tax relief is to reduce the amount that has to be paid from 6.4% to 4.8% at €35,000, from 8.8% to 5% at €100,000 and from 9.6% to 5.4% at €300,000. Hence, the reduction amounts to 1.6 percentage points at an income of €35,000, 3.4 percentage points at an income of €45,000, 3.8 percentage points at an income of €100,000, 4.1 percentage points at an income of €200,000 and 4.2 percentage points at an income of €300,000.

The inequitable nature of the tax arrangements for pension contributions is clearly illustrated by the kink in the net levy series at incomes lying between €35,000 and €75,000. Many workers with an income below €35,000 will pay more as a percentage of their gross income than higher paid workers earning between €35,000 and €75,000. The kink is due to the fact that at €36,000 the marginal tax rate increases from 20% to 41%.

We estimate from a Department of Finance classification of 300,000 public service workers by income range that many of the 92,000 lower paid workers (31% of the total) in receipt of incomes of up to €35,000 will make a higher net payment than 177,000 workers (59% of the total) whose incomes fall in the range €35,000 to €75,000. For the remaining 31,000 highest paid workers (10% of the total) with incomes in the range €75,000 to €300,000 the net levy as a percentage of income will be only a little more than for someone with an income of €35,000.

Because the levy was made tax deductible Government net savings are reduced from €1.4 billion to an estimated €900 million (although there does not appear to be any official source for this figure). In addition it provides a striking example of the 'upside-down' nature of tax reliefs so that higher-income taxpayers benefit most and lower income taxpayers benefit least. The solution is for tax reliefs to be given at the standard rate and, amongst other changes, using the additional tax revenue to increase the level of the State pension to 40% of average earnings (see Making Pensions Work for People published by tasc).

The focus of much media comment and motivation for the levy has been on the disparity in pay (including pensions) between public and private sector workers. Trade unions and others who reject this view, point out the many low paid workers in the public sector. However it must be recognised that certain key workers in the public sector, such as hospital consultants, and others, are paid substantially more than similar employment in other countries such as France and Germany. The levy does not address this issue.

Required adjustments in taxation, pay, and working arrangements, are most likely to be achieved if they are accepted as being equitable. The fairest way to spread the burden of adjustment across the community would be to use the income tax system to take account of differences in individual circumstances and ability to pay. Standard rating all tax reliefs and eliminating those which cannot be justified on sound economic or social grounds would help to improve the equity of the income tax system.

Finally the proposal to use the assets of the National Pension Reserve Fund to recapitalise the banks means that it is now recognised that this fund is not a ‘pension fund’ in the accepted sense. It is an anomaly that the State is both borrowing and making an annual contribution of €1.5 billion to the National Pensions Reserve Fund. To the extent that these funds are then invested in equities it is similar to the State behaving as a hedge fund. The National Pension Reserve Fund should be wound down and the funds used to support current Government expenditures and job creation.

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