The Irish Social Security System, a Time for Change?

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The Irish Social Security System is continually under review due to its central role in the government's approach to reduce friction's in the labour market. David Brocklebank traces the Irish Security System's development from the Beveridge Report, and points alternative scenarios.

Introduction

The distribution of income that could pertain in a core market economy diverges from what is regarded by the majority as equitable, creating a requirement for a system of social security. Transfer payments are the primary mechanism by which the government intervenes in the market and redistributes income on the grounds of equity and social efficiency. Some believe that the benefit or utility an individual attains from an extra unit of income diminishes as income rises. By redistributing income, total benefit from it can be increased. The social security system attempts to at least partially equalise the marginal benefit of income across the income range. It aims to reduce, though not remove, this difference, since a total removal of this difference would create economically crippling disincentive effects.

The Irish and British social security systems are similar, the latter having its foundations in the Beveridge report of December 1942. Minor alterations have been made, though essentially our system dates back to the time of World War II. When we refer to social security, we refer to cash benefits, health care, education, food, housing and other welfare services. For the purposes of this essay I shall focus on cash payments, since most of the notions of altering the system are rooted in changes to the cash benefits system. Firstly, I propose to look at the reasoning behind and the operation of the current system and then consider the view that perhaps the current system is somewhat dated and a fundamentally different system should be implemented.

Foundations of the current social Security System

The core element of Social Security envisaged in the Beveridge report was the introduction of a nation-wide social insurance scheme. Beveridge outlined a system of compulsory social insurance that could provide a minimum standard of living without having to resort to means-tested benefits. If a person had not made contributions to the scheme and found themselves in poverty then a national, means-tested assistance scheme would provide benefits for that person. Beveridge emphasised the necessity of having considerably less benefit payable to an individual on national assistance compared with social insurance.

The level of benefit is based on the notion of subsistence income, raising a number of problems. Standard rate of benefit payments to an individual do not internalise the differences in rent an individual has to pay, owing to the variation rent prices across the nation. Including the average rent costs in calculating a subsistence level payment results in some claimants living below the subsistence level, but finding a practical solution to rectify this proved elusive. A second problem arises from the need, from an insurance perspective, to predict the levels of payments in the future that would be required to maintain a "subsistence" standard of living. The rate at which prosperity increases should have some impact on the level of payments, because it is a determinant of what could be regarded as a subsistence standard of living, though this rate is rather unpredictable. This unpredictability in the level of benefit payments results in an inability to calculate premium payments accurately. This requires the government to act in a sense as "payer of last resort" to make up the difference between the contributions and the payments.

Beveridge believed that society was more willing to pay into an insurance scheme when they were aware it was going to finance their retirement and any contingencies which may arise, as opposed to paying a general tax.

The Beveridge Principles

The principles embedded in the Beveridge report are those which underpin the Irish system of social security. Beveridge outlined six fundamental principles of his plan for social security, which to varying degrees are contained within the Irish system.

- *Flat rate of contributions.* It was envisaged that all insured persons not dependent on their means would pay the same contribution for the same social security. In Ireland, we have an earnings related scheme, though this principle is maintained to a certain extent by a ceiling on the amount of income considered when calculating the social security contributions. Those on higher incomes pay more tax and, therefore, fund the state's share of the social insurance fund.
- *Flat rate of subsistence benefits.* The same level of benefit is received, irrespective of the level of earning prior to unemployment, disability or retirement.
- *Unification of administrative responsibility.* In the interests of efficiency and economy, each insured person makes a weekly contribution to a single social insurance fund from which all benefits and other payments will be made. In the Irish case, the Pay Related Social Insurance payments are made directly into the coffers of the department of Social Welfare, doing away with the idea

of a single fund. This is heightened by announcing any rate changes in the budget, treating PRSI like a tax, instead of a social insurance fund.

- *Adequacy of benefit.* Benefits should be set at a subsistence level, to provide an adequate standard of living. It allows scope for additional voluntary provision, though these are not regarded as vital. It is debatable that the levels of Irish benefits are pegged at a standard adequate to live on.
- *Comprehensiveness.* Social insurance should only include risks that are uniform and general. Anything that can be covered by social insurance should be, decreasing the reliance on national assistance or voluntary insurance. Voluntary insurance may in some cases not be viable, owing to the problem of adverse selection and misinformation.
- *Classification.* Social insurance schemes must embody the entire labour force and not just employees. The insurance scheme must act as one for all citizens, not just segments of the population. In Ireland, the social insurance scheme has recently been extended to those who are self-employed or in part-time work.

The Irish Social Security System

The Irish system of social security was built around these principles, developed in the early 1940's. Changes have been made to the system, though none of them may be regarded as fundamental. These changes have made the system more complex and increasingly difficult to understand. It is an unfortunate fact that the majority of those relying on the bulk of the welfare services are the less educated segments in society, who have tremendous difficult understanding their entitlements. Current estimates suggest that only about one in three of those who are entitled to Family Income Supplement (FIS) actually claim it. Complexity in the system results in increased administrative costs, at the expense of the tax payer and those receiving benefits from the system.

Complexity is one of the arguments against continuous tinkering with, instead of a radical reform of, the system. The current system may be described as "a patchwork quilt falling apart at the seams"[1]. Owing to the changed economic conditions, some argue that social insurance is an unnecessary element of government interference in the market place. Financial markets and financial instruments have developed to such an extent that they may better serve the interests of those currently making social insurance contributions. These instruments, such as critical illness plans and retirement plans, are so specific that they may provide a substantially more attractive option than the state-administered system. The private sector may not be seen just as providing services complementary to the state, but in direct competition with it. This was not the

[1] Hills et al. (1994). Quoted in relation to the British system, but equally applicable to the Irish system.

case when the current system was developed, though now it must be regarded as a viable alternative. The first country to recognise this has been Chile, where a compulsory pension scheme has been implemented which is run entirely by the private sector. No matter how advanced the financial markets become in handling such risk, the problems with insurance such as adverse selection still remain. Nevertheless, the markets may be more responsive in coping with such factors as the changing demographics of a society.

The current system was not designed to cope with such high numbers of unemployed persons seeking assistance. Currently there are 80,100 persons claiming unemployment benefit, while there are 199,400 persons claiming unemployment assistance. It was initially envisaged that unemployment assistance would be a payment of last resort as most people would have made contributions to the social insurance fund. They would, therefore, be in a position to claim unemployment benefit instead. The current concept of long term unemployment was not intended to be dealt with by the current framework. Growth in long term unemployment in the 1970's and through the 1980's has impeded the concept of social insurance, since some segments of the population never have a chance to contribute to the fund.

The work disincentive effects created by the current system provide a urgent reason for looking at an alternative system. Flaws in the system exist where, in some circumstances, an increase in gross income actually results in a reduction in net income. This is because, as income increases, more tax is paid and certain means-tested benefits are reduced or withdrawn. The replacement ratio is the ratio of family net income when working to family net income when not working. Currently, replacement ratios in excess of 80% are experienced at earnings up to around £12,000, and affect an estimated 37,000 employed and 23,000 unemployed persons. It is vital that any reform of the current system addresses the problem of discouragingly high replacement ratios.

Replacement Ratios '95/'96

Income	Single person	Married couple 4 children (no FIS)
5000	88.3	175.7
6000	75.7	149.4
7000	66.3	129.9
8000	58.9	114.9
9000	53	103
10000	49.3	103
11000	45.2	97.4
12000	41.8	92.43
13000	39.4	87.97
14000	37.6	83.87

Basic Income

The most prominent, and perhaps the most radical, alternative system is that of Basic Income which involves integrating the social security system with the taxation system. Basic Income is an extremely simple system compared with our current system. It involves paying a weekly income to every person, regardless of their status or means. It has appeal to those on both the right and left of the political spectrum. It is a non-targeted payment, meaning that those in the wealthiest sections of society will receive the same state benefit as those in the poorest. This would be financed by removing all tax allowances and charging one single rate of tax on all income after the Basic Income, which is not taxed.

There are two prominent advantages to such a scheme. It would simplify the system immensely, eliminating the need for rent-seeking tax lawyers and accountants, whereby productive resources are directed into economically unproductive sector, stimulating a wasteful use of resources. More importantly, it would eliminate the disincentive to work created by the current social security system. Basic Income removes the barrier between the transition from unemployment to employment.

Apart from the reduction in the poverty and unemployment trap and its sheer elegance, Basic Income has other advantages on a more social rather than economic level. It provides an automatic payment thereby doing away with the problems of individuals not being aware of their entitlements and the stigma associated with receiving social welfare. It is also an independent income to all, thereby incorporating a certain element of liberty.

There are indeed disadvantages associated with Basic Income and some would argue that the negative elements of the scheme outweigh the positive factors contained in it. Since Basic Income is a universal scheme, it is a poorly targeted method of tackling poverty. The initial notion of equalising marginal benefit of income is removed, since everyone is receiving the same income irrespective of circumstances. There is a distinct lack of flexibility to meet different needs in different ways. For example, an individual who is disabled may require more income to support themselves than an able-bodied person. In attempting to maintain simplicity and cost control, Basic Income schemes do not usually allow for specific special payments. Probably the most inhibiting factor restricting Basic Income to the textbook is the substantial tax increase required to finance it, which would lead to problems of tax compliance and an extension of the black economy.

Basic Income with payments of £60 a week to adults and £17.40 to children, priced in '93/'94 figures, would require a single tax rate of 68.6%, assuming that all tax allowances and exemption limits were abolished. Overall, this would

Basic Income with payments of £60 a week to adults and £17.40 to children, priced in '93/'94 figures, would require a single tax rate of 68.6%, assuming that all tax allowances and exemption limits were abolished. Overall, this would increase the equity of income distribution, though to what extent would depend on how Medical Cards, etc. were treated. A full Basic Income scheme may discourage students from dropping out of school because they would be taxed at the higher rate, yet still only receive the same Basic Income.

Basic Income would have a number of rational behavioural effects: naturally, many of these are almost impossible to estimate. A reduced replacement ratio may result in greater labour supply and possibly a reduction in numbers unemployed, depending on other economic factors. However, this may be counterbalanced by reduced work effort among the current labour force, meaning that more persons may take time off to study or work full time in the home. The high levels of taxation may promote a distinct reluctance in most workers to work overtime. There is a danger that a Basic Income scheme may bring about an inflexible labour force, which would have serious negative implications, especially in an era of footloose industries. Another danger of Basic Income is that it may stimulate a brain drain. Single employees without dependants, except those on the lowest incomes, expect to lose the most because of the introduction of Basic Income. These people tend to be well-educated college graduates and their emigration would cause a negative shock to the economy. Another problem that may arise would be the immigration of European citizens entitled to claim Basic Income in Ireland. In addition, the black economy will grow, owing to the increased incentive to evade taxation because of its higher levels.

Though the concept of a universal Basic Income sounds appealing, it has problems related to its "side-effects". Undoubtedly the most important of these is the behavioural effects surrounding the impact of the high tax rate required to support the system. Its unpredictable influence on the economy is one of the primary reasons why Basic Income has never been implemented in any country to date. The report on the Integration of the Tax and Social Welfare Systems(1996) came to the conclusion that "the introduction of a full Basic Income scheme would be highly problematic and the high tax rates needed to fund it would have a deleterious effect on employment".

Partial Basic Income

Another option is for the introduction of a partial Basic Income scheme, which would rely on some elements of the current system in conjunction with a limited form of Basic Income. It would represent a less radical solution to the problem and may be regarded as a "stepping stone" towards full Basic Income. It would allow us to observe the impact of changes on a smaller scale and we could, if these were not overtly negative, move gradually towards full Basic Income.

During this transition, the system will become even more complex, exacerbating many of the current problems.

Partial Basic Income involves the abolition of personal tax allowances but the retention of certain elements of the welfare system already in place. The Basic Income payments would not be on a scale to provide an adequate standard of living; nevertheless, it would recognise unpaid work, redistribute income to different household members and reduce the "dependency" status of persons in receipt of social welfare. A partial Basic Income of £21 per adult requires no tax increase owing to the reduction or elimination of certain social welfare payments (Higher Education maintenance grants, training allowances, etc.) and the removal of all allowances in the tax system. A partial Basic Income of £38 would require a single tax rate of 41-44%. It is important to note that payments to children are not included in the above costings. If they are included with a Basic Income of £21, a tax increase of 4% on the standard rate of tax would be required. An income of £38 would require a single rate of 44-47%.

If a Partial Basic Income scheme were introduced, then the problem would arise of how to deal with the social welfare payments above the basic income. Options would include taxing all residual social welfare payments, exempting social welfare payment from tax or grossing up social welfare payments and taxing them. Given the complexity of operating a twin Basic Income/Beveridge systems, it would be administratively simpler to exempt social welfare payments from taxation, though this does, to some extent, contradict the principle of the Basic Income system.

Variation: Basic Income for Children

A variant of partial Basic Income is a Basic Income for children. Under the current system, the majority of child payments are linked to the employment status and income of the parent. Therefore, if an unemployed person takes up employment, they lose not only their own benefits but also their children's benefit. This narrows the gap between basic industrial wages and social welfare payments. In other words, it increases the replacement ratio. Partial Basic Income for children would ease the problem of high replacement ratios, especially for large families, by removing the link between parental employment/income status and child allowances. The new payment would be universal and would operate along the lines of the current system of child benefit, though the level of payment would be substantially increased to reflect the actual costs of sustaining a child. It would involve the integration of Child Dependence Allowance, Child Benefit, Family In Supplement and child additions to the income tax exemption limits. A monthly payment in the region of £85 would require an increase of 3% on the standard band and an increase of 6% on the higher band, spreading the costs equally between the two bands. The group reviewing the integration of the tax and social welfare system came to the conclusion that a Basic Income for children would reduce replacement ratios for those not in receipt of FIS at all income levels, but those receiving FIS at lower income levels would face increased replacement ratios. This problem could be eliminated by retaining a residual FIS component.

The introduction of a Basic Income for children would both reduce replacement rates and decrease the complexity of the system. The tax increases required to finance it are minor compared with what would be required to finance a full Basic Income scheme. The introduction of Basic Income for children would be a step in the right direction, leaving open the possibility of universal partial Basic Income, or even full Basic Income.

Conclusion

Undoubtedly, Basic Income, either partial or full, provides an alternative to the current system. The flaws in the current system need to be weighed against the flaws in any alternative system. Given the uncertainty in accessing these, and the possible substantial negative economic shock that full Basic Income could initiate, it is unlikely that full Basic Income will be introduced. Some have suggested that, within the Department of Social Welfare, there is minimal impetus to radically overhaul the system because its current complexity is in the interests of civil servants who can claim "specialist" knowledge. The move for reform is unlikely to originate from this source, though given the complexity of the issue, those with an intimate understanding of the current system and its flaws will have to provide the impetus for change. Perhaps the introduction of Basic Income for children would provide a starting point for a radical overhaul of a dated and inadequate Social Security system.

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