Pensions Policy

By Bryn Davies May 2004

A New Left policy document arising from discussions hosted by the New Left Unions and the Socialist Campaign Group.

Participants and organisations represented include:

- Bryn Davies – Union Pensions
- AMICUS
- Greater London Pensions Association
- Help the Aged
- NATFHE
- National Pensioners Convention
- NUJ
- Professor Peter Townsend – LSE
- PCS
- Richard Murphy – People's Pension
- Socialist Campaign Group of Labour MPs
- TGWU
- UNISON

Background

The United Kingdom faces a Pensions Crisis.

But it is not a crisis caused by people living too long or retiring too early, and it is certainly not caused by an insupportable State pensions burden. Instead, it is a crisis caused by too many retired people living in poverty — and under the existing pensions framework it is set to get worse. What this means is today's worker on average earnings or less can expect to be in poverty when he or she retires.

We believe this can only be avoided by giving a greater role to State pensions.

The Government's response to the pensions crisis has so far been one of apparent complacency, despite the growing body of concern voiced in particular by the pensioners' movement and the TUC. Ministers appear to believe that present policies — based essentially on a massive extension of means-testing and increased voluntary provision through capital markets — are the answer.

But this flies in the face of clear evidence that:

- reliance on means-testing inevitably leads to poor and inefficient coverage, perverse incentives, and social division; and
- private provision has inherent shortcomings making it unsuitable as the foundation stone of pension provision.

The Success of State Pension Provision

One of the most illogical aspects of the Government's approach to pensions is its pursuit of initiatives which are known to fail. Ministers continue to favour means-testing and private provision, or schemes with no proven track record, like stakeholder pensions, while ignoring the potential of greater State provision, which experience shows can deliver what people really want. There are, of course, shortcomings in our existing State system, but these can be addressed by strengthening provision, rather than abandoning it.

The key advantages of the basic State pension are public acceptability and coverage. Polls show consistently that while people do worry about whether they will receive their State pension, most would still prefer a universal State benefit to a private arrangement. The concept of social solidarity between those at work and those in retirement, while seldom articulated, is widely accepted. Also accepted is the concept that an adequate standard of living in retirement has to be paid for — providing those in work can in turn look forward to similar benefits when they retire.

Pensioners are also generally perceived as being entitled to a decent standard of living as of right, without any means testing. The UK system centres on the concept that paying contributions during a working lifetime brings an entitlement on retirement, not a hand-out. But unpaid work — particularly by women with family responsibilities — must also be recognised as counting towards entitlement, as should periods out of work due to ill-health, disability and involuntary unemployment.

We also see the State Second Pension (S2P), previously known as the State Earnings Related Pension Scheme (SERPS), as crucial. First, the S2P offers exactly the elements the Government has identified as necessary for a successful pensions system:

- equity between members, with benefits and contributions based on each member's full earnings record
- full transferability of rights, with no penalty on switching from job to job
- full protection of rights in line with average earnings up to retirement and inflation thereafter
- low administration costs
- protection against investment risk.

Secondly, the S2P is capable of paying worthwhile benefits: current pensioners are receiving benefits that, when taken with the State basic pension, are not far short of the original SERPS target of half-pay on retirement for a worker on average pay. It is only in the longer term that the SERPS cuts made by the Conservative government will start to have a significant impact. In terms of the main test that should apply — the ability to deliver adequate benefit — the success of State earnings-relations pensions is little appreciated but very real.

Those who advocate greater State provision need not be apologetic: state pensions have been shown to work. All that is needed is more generous provision, starting with a higher basic pension, and to put in place better longer-term protection for State entitlements.

The Failure of Private Pension Provision

Private pensions, based on voluntary contributions by employers and employees and on investment markets, have an important and continuing role. However, both the pensions industry and the Government have overstated how well they can deliver adequate and secure benefits and, by implication, the extent to which they are a suitable alternative to adequate State provision.

Occupational Pensions

The claim that occupational pensions were the "welfare success story of the century" now looks over-ambitious in the face of problems with investment markets and falling real returns. Many scheme members have been left with benefits now significantly short of what they had reasonably expected. We support such schemes where they work well, but it is clear that they can only offer coverage to part of the working population. In addition, the trend from defined benefits to money-purchase schemes, with the associated reduction in benefits, means both the quality and quantity of occupational provision may well decline in the longer term.

Personal Pensions:

The failure of the last Conservative government's policy of relying on personal pensions is now also clear. The pensions mis-selling scandal (at a cost of £14 billion and still counting), plus the high-profile collapse of Equitable Life, mean the intrinsically high-cost and high-risk nature of this type of provision is far more widely understood. Again, a personal pension might be suitable for some workers, but these are a minority and even for them it should be viewed as an added extra, not a replacement for adequate State provision.

Stakeholder Schemes:

The incoming Labour Government introduced Stakeholder Pensions as a low-cost form of provision open to all in response to the limitations of personal pensions and the inadequate coverage of occupational schemes. However, not even their biggest fans can claim Stakeholder Pensions have been a success. Relying on voluntary action by those in Government's target group, who tend to be those with the greatest pressure on their disposable income, has produced a very low take-up. There is nothing to suggest this will change in the future, at least not without a move to greater compulsion. In addition, the inefficiency of this type of scheme is perfectly illustrated by the pensions industry's complaint that the 1 per cent cap on expenses — which over a working lifetime means that up to a third of the member's contributions get eaten up by the provider — is too low. The solution is not to throw even more of the money needed to pay for decent pensions at inefficient private sector providers — it is to strengthen the State scheme.

That said, there will always be a role for private pension provision. The question, however, is what should be the private sector relationship with adequate State pensions? The Government's stated intention is to see private provision replace State pensions. However, the private sector's record — as opposed to its rhetoric — suggests its potential is limited to a complementary role.

What needs to be done

The State Basic Pension:

Improvements are needed to ensure the great majority of pensioners have an absolute minimum level of pension, both now and in the future. In particular:

- **pensions should be increased immediately to at least the level of the current Guarantee Credit**, i.e. £105.45 per week for a single pensioner and £160.95 for a couple from April 2004
- **pensions should be linked thereafter to national average earnings**, to ensure that as pensioners get older their living standards do not fall behind those of the working population
- **the single person rate should, in the near future, be further increased towards a target of 25 per cent of average earnings**
- **there should be an extra £22 per week for those over 80**
- **there should be no change in State pension age**.

The State Second Pension:

Changes are also required in S2P, so that it fits in with the basic pension and to ensure proper credits for family responsibilities and for those on low pay and/or with broken employment. The intention should be, however, to provide an overall State pension offering half pay on normal retirement for those who were on average earnings, with a higher proportion for those on lower pay.

The National Insurance Fund:

These changes need to be accompanied by changes to the institutional arrangements for State pensions and how they are financed. There should be a return to the approach originally envisaged, with autonomous finances for the National Insurance Scheme derived from broadly equal contributions from employees and employers, supplemented by Treasury payments for non-working members credited with benefits. The Scheme's finances should be supervised by an independent board representing contributors and pensioners. The board would be responsible for managing the Scheme within parameters set by legislation.

Greater Protection for Accrued Rights:

Members' accrued rights in the State pension scheme should be better protected. First there should be legislation, like that covering occupational schemes, under which accrued benefits cannot be changed without individual consent. Secondly, all members should be sent an annual statement of their benefits. All too often, Governments have been able to get away with making changes to accrued as well as expected State benefits simply because members did not know how they would be personally affected. Governments will be less eager to make changes, even in future benefits, if they had to write to each member quantifying the effect. Finally, members' entitlements to earnings- related pensions should be expressed, at least in part, in special pension bonds paying a guaranteed rate of return. There would be scope to use money raised in this way as capital to fund public services.

Better Private Provision:

We believe wider pension provision is still needed, on top of an improved State scheme. While the target for a State pension of half pay on retirement offers more than most people can expect at present, in the longer term all workers should be able to enjoy the level of total retirement income at present only available to those in private schemes able to offer two-thirds of final pay or more. We therefore support the phased introduction of a requirement that all employers and employees contribute to private arrangements to achieve this longer-term objective.

Paying for Better Pensions

The obvious question raised by these proposals is can we afford them? Opponents of greater State provision produce frightening figures to suggest we can't, usually by pointing to the increasing number of people aged over 65 compared to the working population. However, the important factor is not the size of the working population but its productivity, and productivity is normally assumed to grow at a faster rate than the number of retired people. In other words, as the economy grows, we can afford to offer improved living standards to both the working population and to pensioners. The working population's share will fall but within a growing economy there is still scope to offer them higher living standards.

In any event, we believe that the great majority of workers would be prepared to pay more to ensure that today's pensioners receive a decent pension — as long as they are confident they in turn will receive the same when they retire. Strengthening the State scheme and giving workers a clear entitlement to their benefits are much better ways of achieving this than depending on the uncertainties of capital markets.

In the short term, our proposals can be financed by the changes to the National Insurance Scheme outlined above. At present the scheme is running a substantial surplus and that, together with the restoration of the Treasury Supplement that existed until 10 years ago, would pay for an immediate increase in the State basic pension. This would of course require an increase in general taxation, but provided this were done in a transparent way — with pensioners seen as the direct beneficiaries — there would be sufficient public support to make it politically acceptable. It would, however, have to be accompanied by the proposed institutional changes to ensure those who had to the meet the cost would also benefit in turn. In the longer term, the extension of the State second pension will generate substantial additional income for the National Insurance fund to pay for the higher pensions that we propose.

Bryn Davies

19.05.04