



# Pension Reform – After Turner?

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**Presentation to the Parliamentary Labour Party  
Work and Pensions Committee  
10<sup>th</sup> January 2006**

Dr. Ros Altmann



# Pensions Commission Themes

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<u>Theme</u>	<u>Pensions Commission verdict</u>
■ Current situation.....	Unsustainable, inadequate
■ Demography and retirement....	Unrealistic expectations
■ State pensions.....	Complex, women, get worse
■ Role of employer.....	Affordability, directors unfair
■ Private pensions.....	Contributions, confidence, trust
■ Compulsion vs. incentives.....	Will voluntarism work?



# Pension basics

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- Pensions have two functions - same name but not same
  1. Social insurance - original idea
  2. Savings vehicle
- These two functions have become confused
- Paternalistic employers supported lifelong workers
- Government relied on employers and cut state pensions
- Cuts supposed to be offset by increasing private pensions
- This not happening, need to understand what's going on



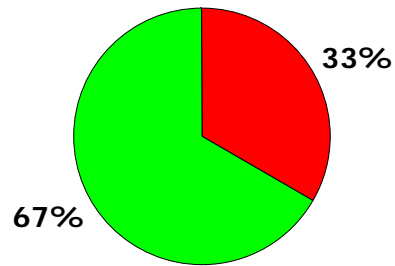
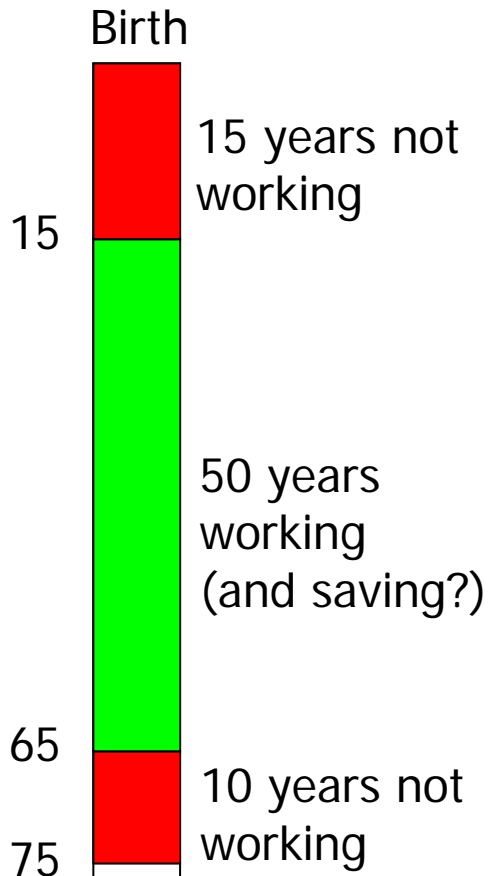
# Demography

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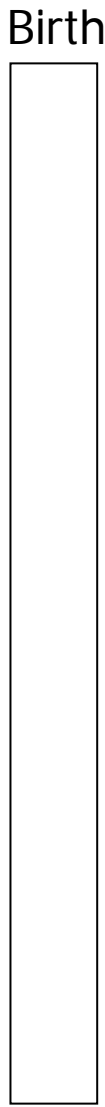
- Demography explains part of pension history
- Pensions helped baby boomer employment 1970's/80's
- Early retirement, generous pensions, restructuring
- Baby boomers reach pension age after 2010 – ageing pop
- Not enough young people to fund future pensions
- Unrealistic unaffordable expectations
  - save less, work less, live longer, get more pension

**Impossible!**

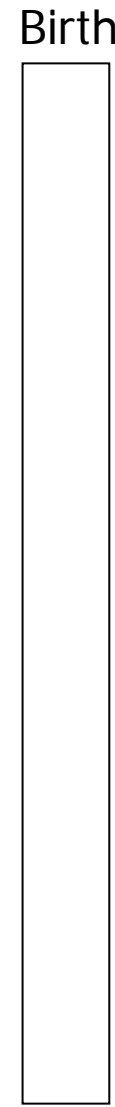
# 1950's



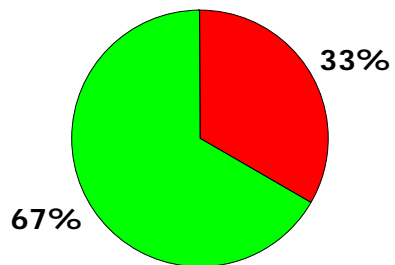
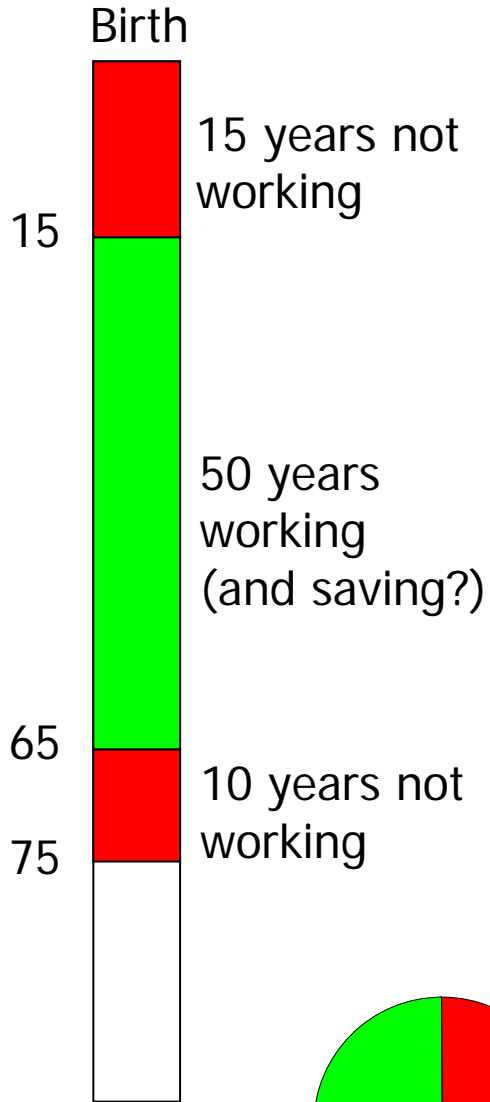
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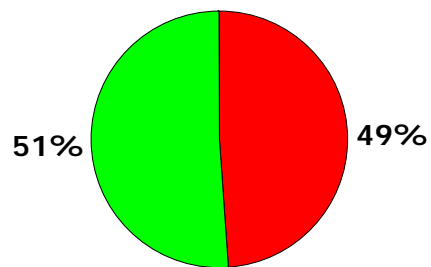
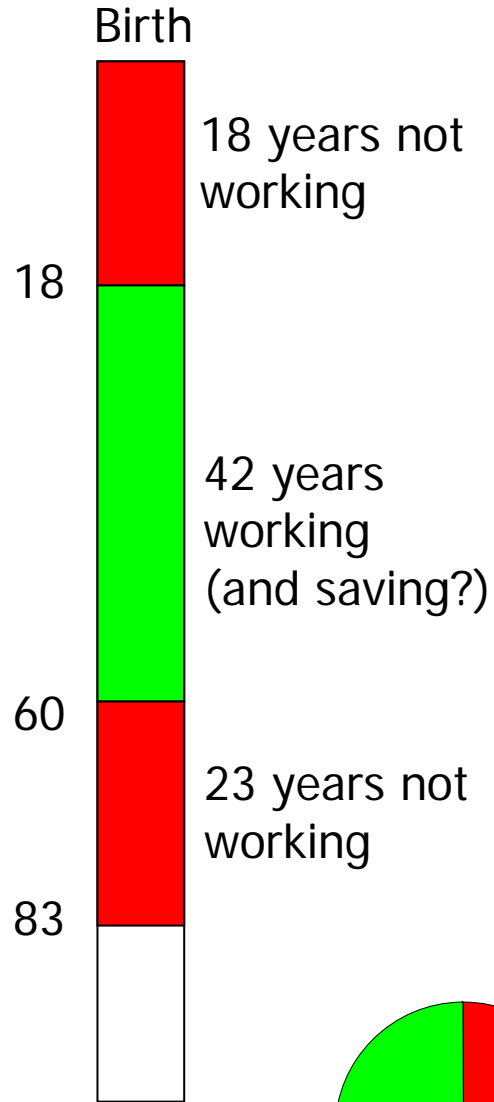
# Future?



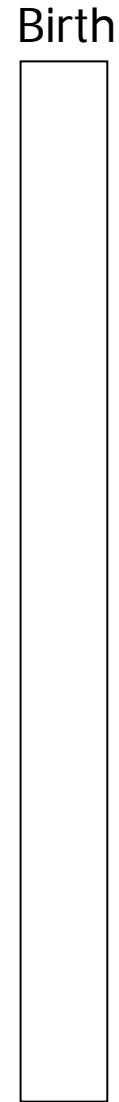
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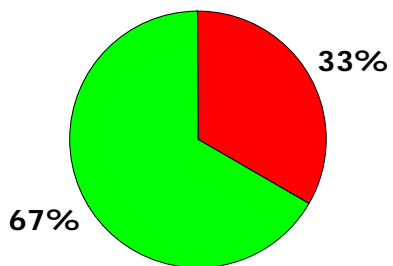
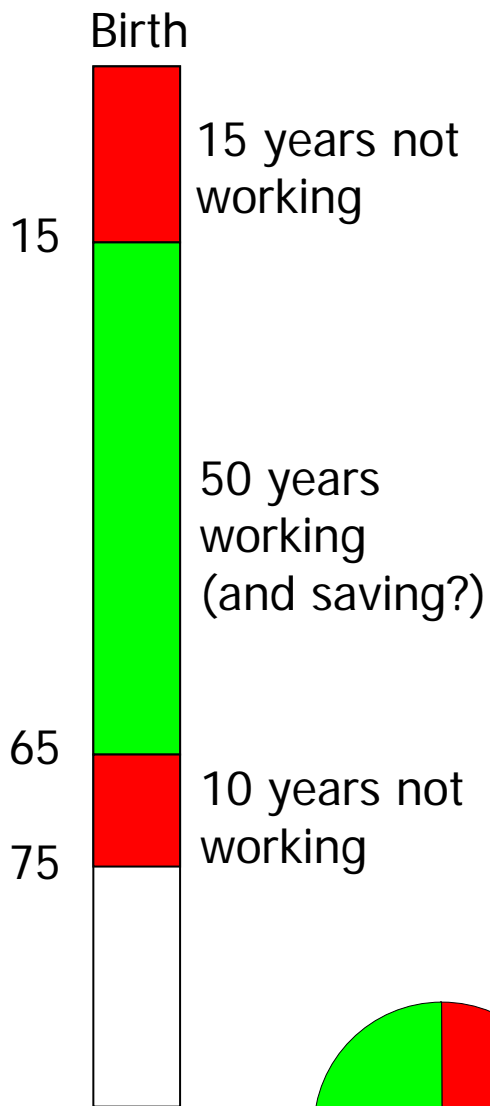
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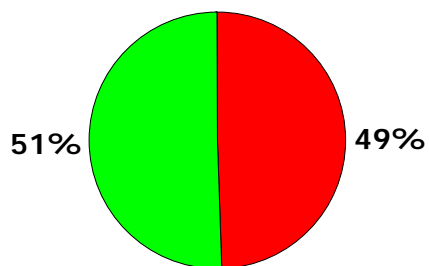
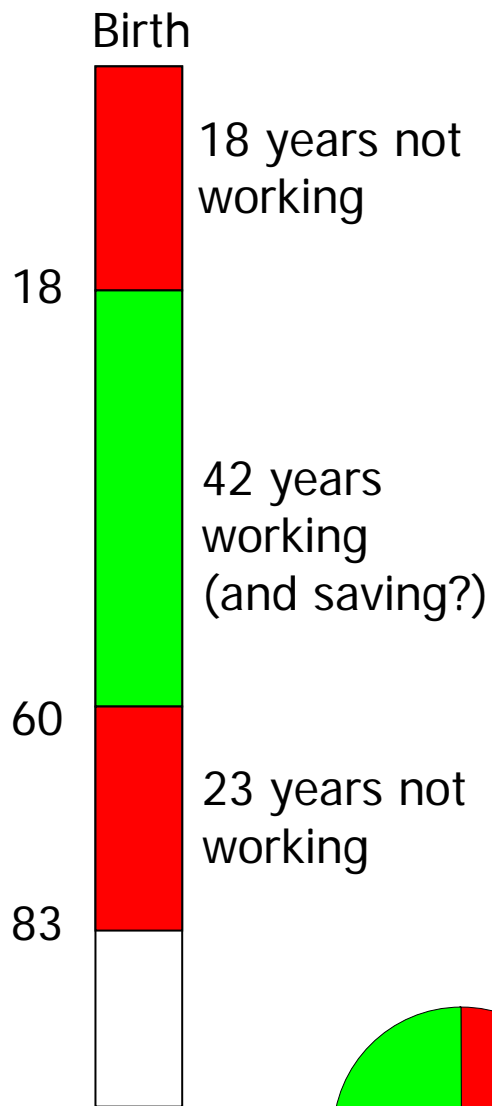
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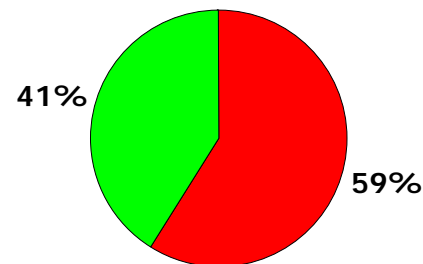
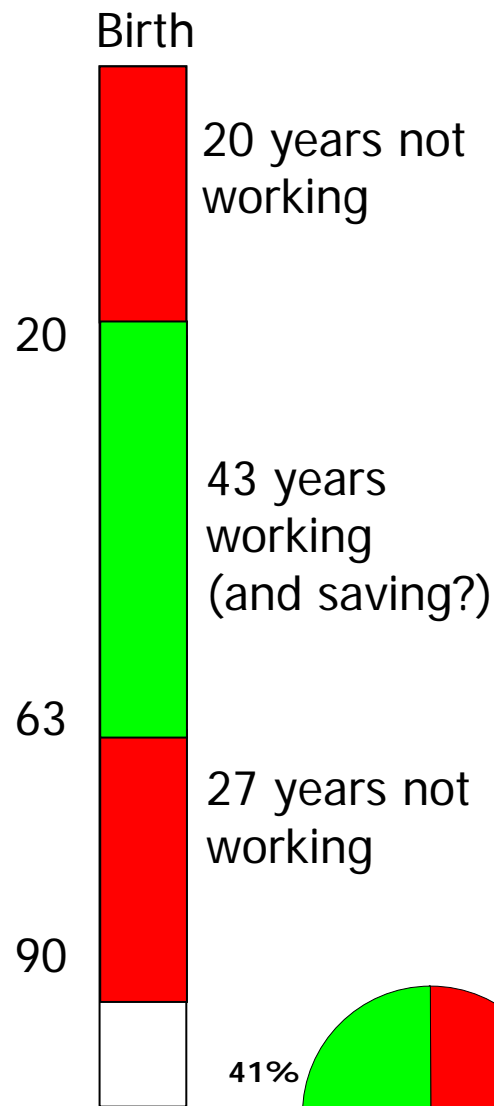
# 1950's



# Now



# Future?





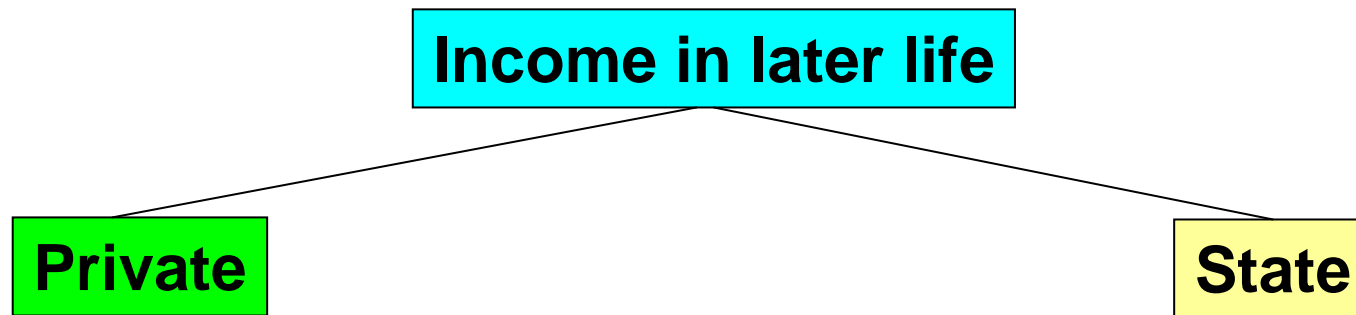
# What's going on?

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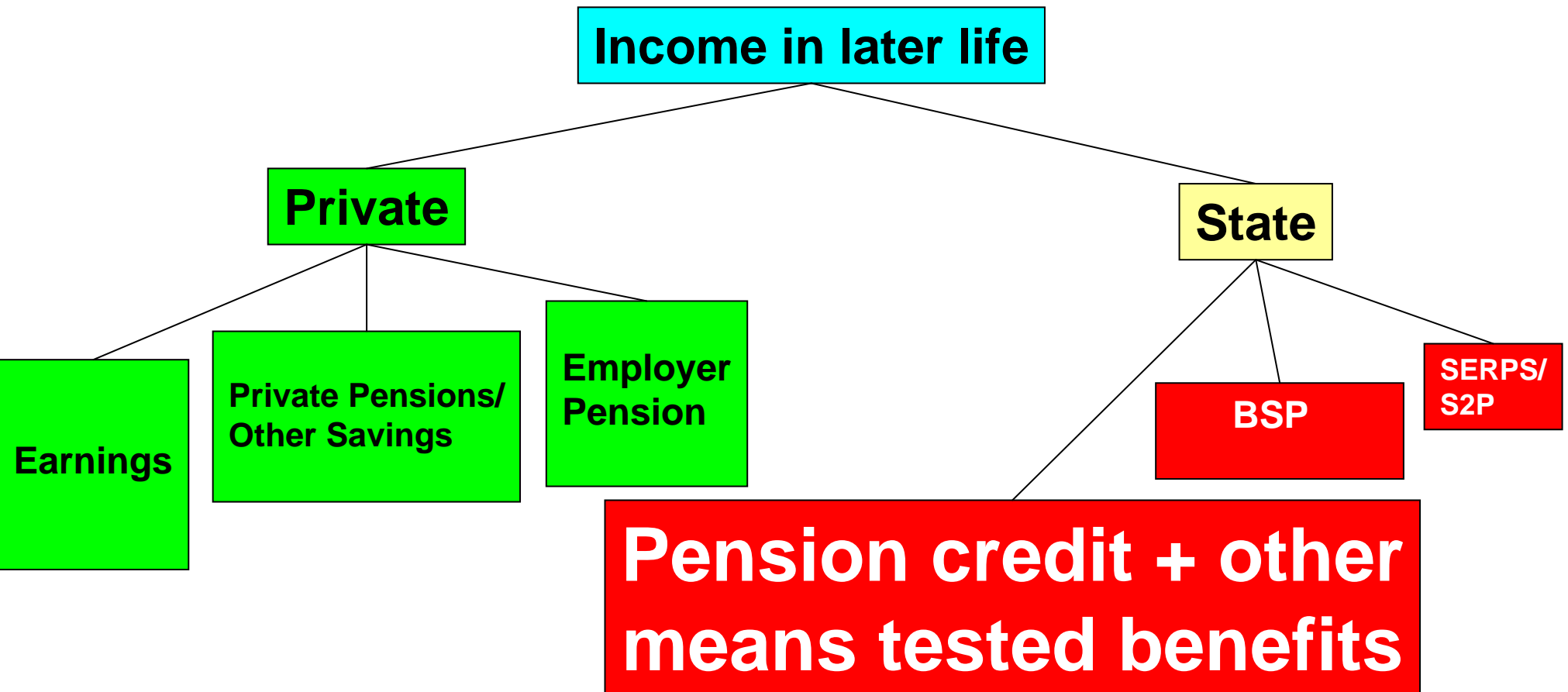
- Working years falling – trends to earlier retirement
- Saving years falling – debts, start saving later
- Retirement years rising – living longer
- Less time to save and expect savings to last longer!
- Doesn't add up – not enough younger people
- What will all older citizens live on?

# Two sources of income for older people

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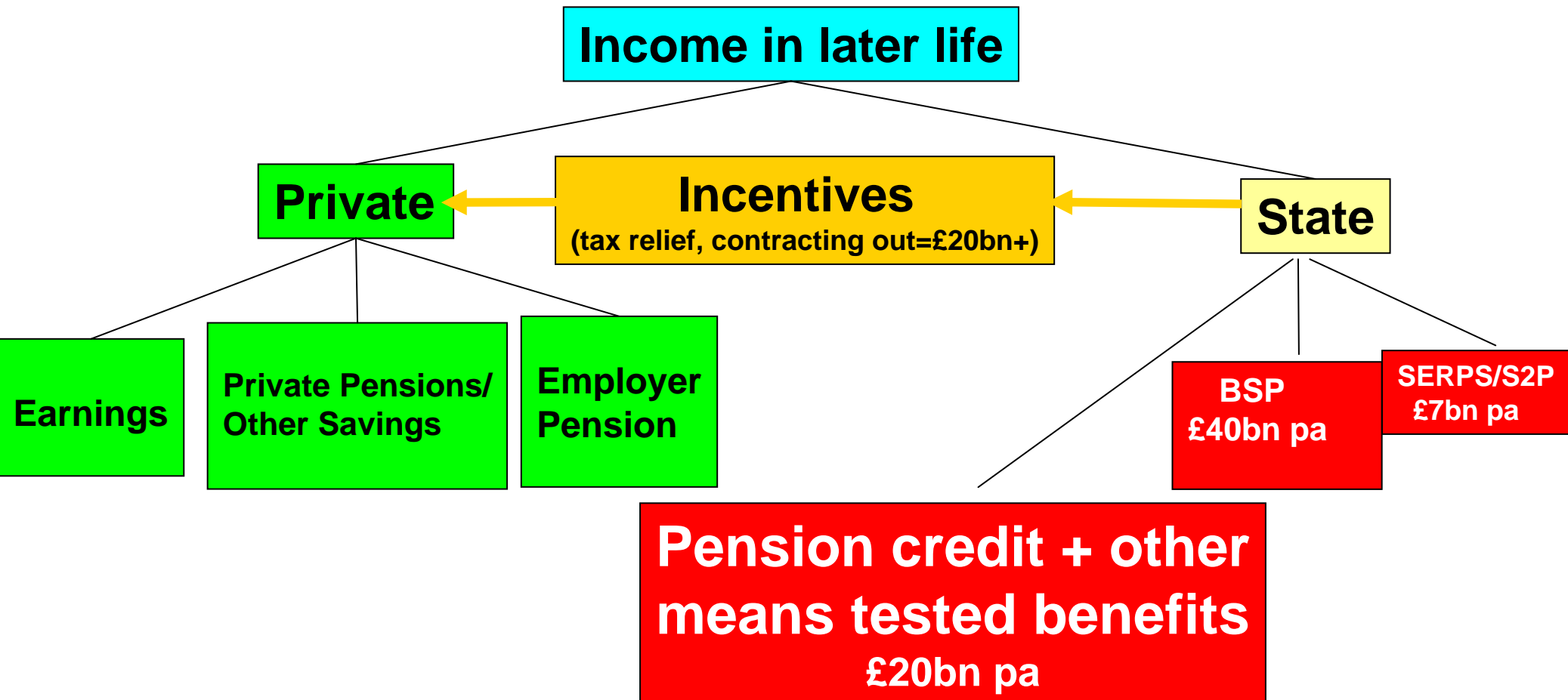


# Private income sources falling ...state costs rising– means testing

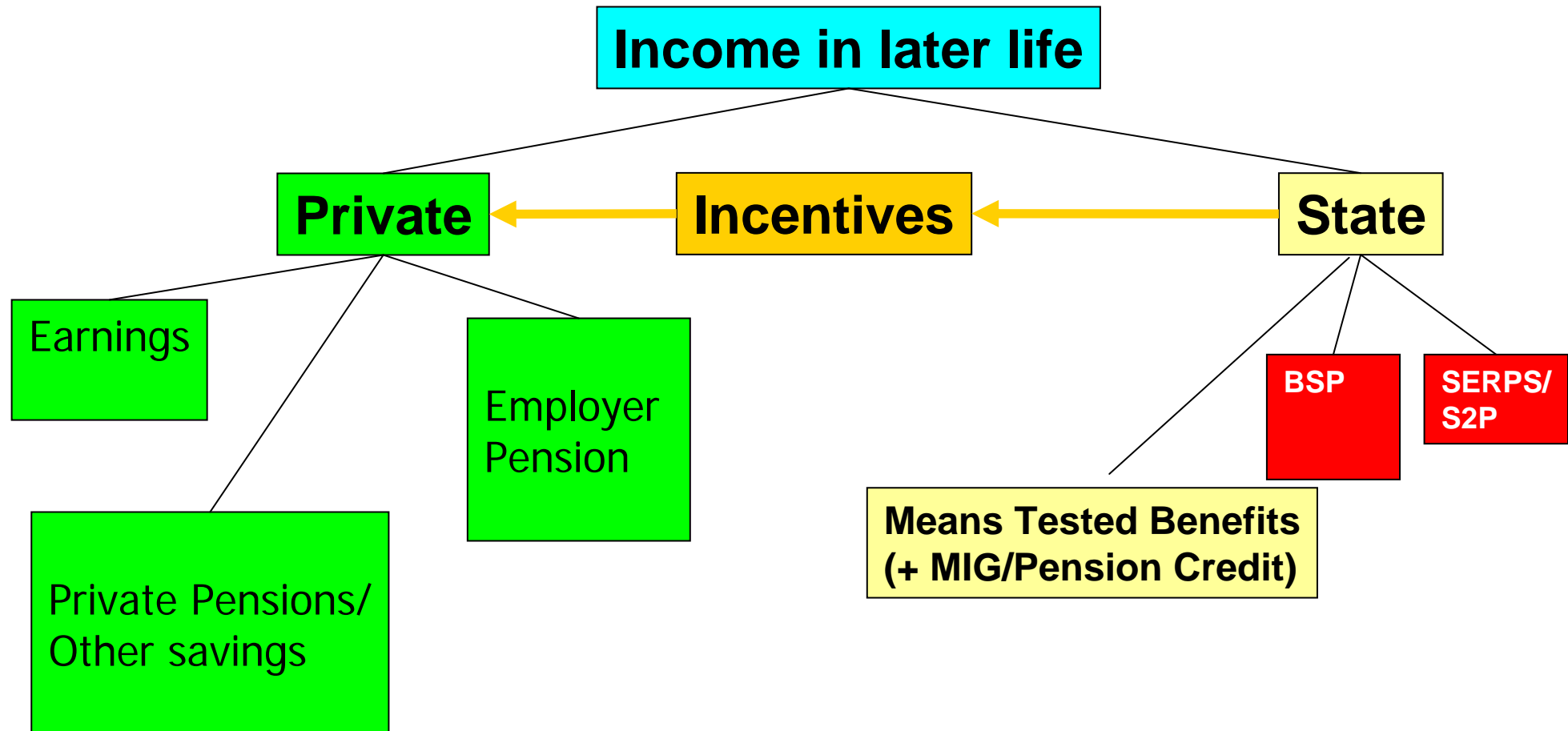


# To control state costs

## ... Government gives incentives



# Theory: reduce state costs, raise private income





# This is not working in practice

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- Incentives not delivering more pension savings
  - Private elements of later life income falling
- Risks poverty and long term economic decline
- This is a crisis, don't let it keep getting worse
- What do we need? New thinking, radical reforms



# State pension reform - questions

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Pensions Commission considered:

- Should State provide just social insurance or more than this?
- Should state system be:
  - Flat-rate or earnings-related?
  - Contributory or universal?
  - Means tested or not?
  - Earnings linked or price linked?
  - Contracting out?
- Choices identified: modify existing system or radical change



# Pensions Commission state pension reform proposals

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- Half-way house compromise:
- Modify but keep 2 state pensions –
  - BSP universal, flat rate, linked to earnings not prices
  - S2P contributory, flat rate, different pension age from BSP?
- Pension credit to remain, but coverage fall to 1/3 not 2/3
- Abolish contracting out for DC not DB
- Raise state pension age to control long-term costs



# Problems of Turner State reforms

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- Still complex and confusing
- Not properly address women and self-employed
- Still too much means testing – poverty, disincentives
- Contracting out still a problem
- Prolongs unfairness and high spending on top earners
- Not radical enough



# State pension problems – my view

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- State pension too low, complex
- Women treated as second class citizens
- Why should state provide earnings-related pension?
- State to do universal poverty prevention, rest up to us
- Individual responsibility has to be understood



# State pension reform – my view

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- Universal flat rate pension, linked to earnings £115pw
- Basic minimum from state
- Transition and residence problems must be addressed
- Maybe start age 75
- Can afford it if redeploy resources



# Sources of funding

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- Net cost of universal citizen's pension c. £7bn 2010
- Tax relief > £20bn pa
- 90% taxpayers earn < £33,000
- Contracting out rebates £7.7bn pa
- Winter fuel, TV etc > £3bn pa
- Higher ceiling for NI – currently very regressive
  - Earnings: £30,000 pay 9.2% NI, £40,000 pay 7.6%,
  - £100,000 pay 3.7%, £200,000 pay 2.3%, £1m pay 1.3%



# Traditional employer pensions

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- Final salary schemes in terminal decline
- Employers see pensions as company 'cost' not 'benefit'
  - Average job tenure 5 years – not lifelong employment
- Traditional pension costs up 5%pa (inflation, mortality)
  - Recognise true costs – wake up to reality!
- Pensions Commission no solution, just slow death
- Schemes mis-used by employers and Government
  - Allowed employers to make promises, told members all safe and protected by law
  - No diversification, directors allowed to behave badly



# Government guilty on final salary

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- PPF good for future – essential BUT
- Biggest social injustice of our time remains unremedied
- > 80,000 people's lives destroyed
- FAS totally inadequate and unfair
- Labour values – fairness and social justice.
  - they worked and saved, did what Government told them
- How can we restore confidence in pensions if this issue not put right? A Labour Government can't turn its back



# Compulsion could be dangerous

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- Already have compulsion in NI
- But Turner proposes employer compulsion plus auto-enrolment in low cost quasi-Government scheme (NPSS)
- Only proposing 8% default – not enough
- What if things go wrong? suitability, mis-selling?
- Need better and fairer incentives for voluntary system



# Incentives

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- Currently only incentive is tax relief – costs £21bn pa
  - $> \frac{1}{2}$  to top rate taxpayers - higher relief not paid to pension
- High earning men get most incentive and highest pension
- Pensions Commission says tax relief 'costly, poorly focused and not well understood'
  - matching payments could be 43% in £ for same cost
- But recommend keeping tax relief and just explain better
- Shame to keep existing expensive inequitable incentives for top 10% of taxpayers
  - Difficulties of final salary prevented radical option



# Proposed NPSS

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- 4% employee, 3% employer compulsion, 1% tax relief
- Admits current tax relief not an effective incentive
- £ for £ matching incentive much more powerful!
- Pensions Commission proposes employer pay 75p in the £, state pay 25p
  - Auto-enrolment optional for employee
  - Low charges
  - State organised admin
  - Approved investment vehicles?



# Concerns about NPSS

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- Big risk contributions will actually fall
    - Nearly half DC contributions now >8% (DB > 20%)
  - Employers to cut contributions
  - 8% not enough. People may think it is
  - No advice, suitability check, financial planning help?
  - Intellectual case for employer compulsion unclear – a tax!
    - Small employers struggle – this is part of pay, mortgage too?
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- ? Have we given voluntarism a proper chance? Citizens pension, better incentives + 'SMART' schemes would help better planning?



# Government criteria for reform

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	Pensions Commission Proposals	Citizens Pension Proposals
<u>Hutton's 5 tests</u>		
Personal responsibility	✓ auto-enrolment good	? clear message
Fairness	X still favour top earners	✓ universal
Affordability	✓ better than now	✓ if redeploy spending
Simplicity	X still complex	✓ same for all
Sustainability	? may need change	✓ changes obvious

BUT ... Still need more...

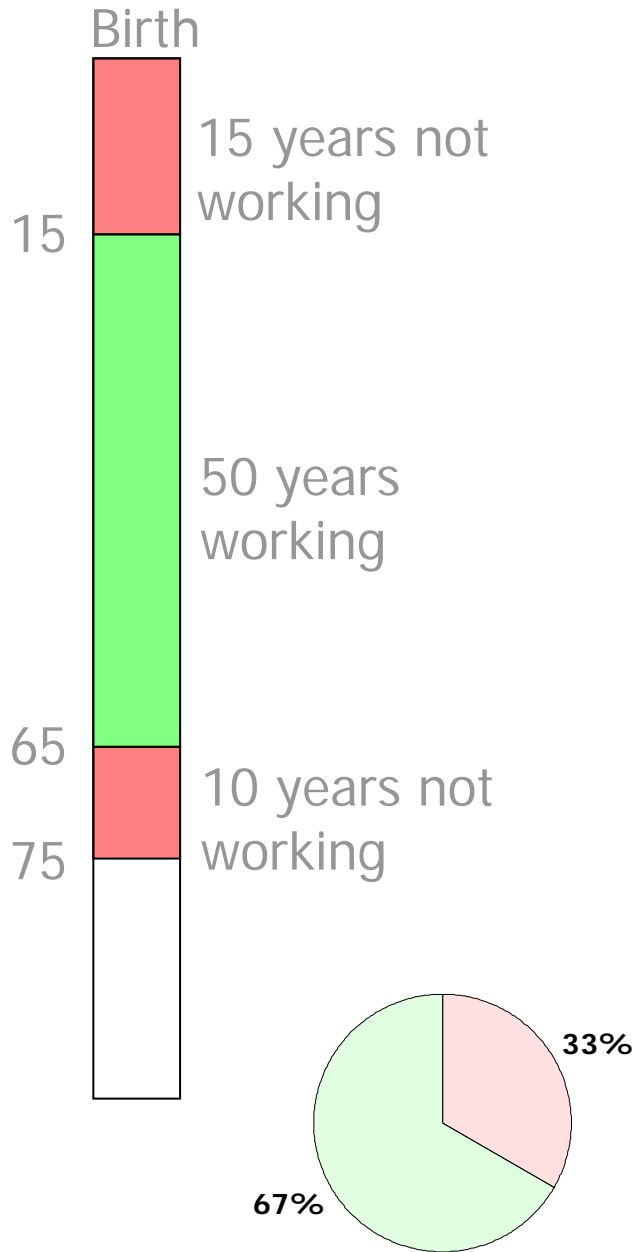


# PENSIONS ALONE CANNOT SOLVE THE PENSIONS CRISIS!

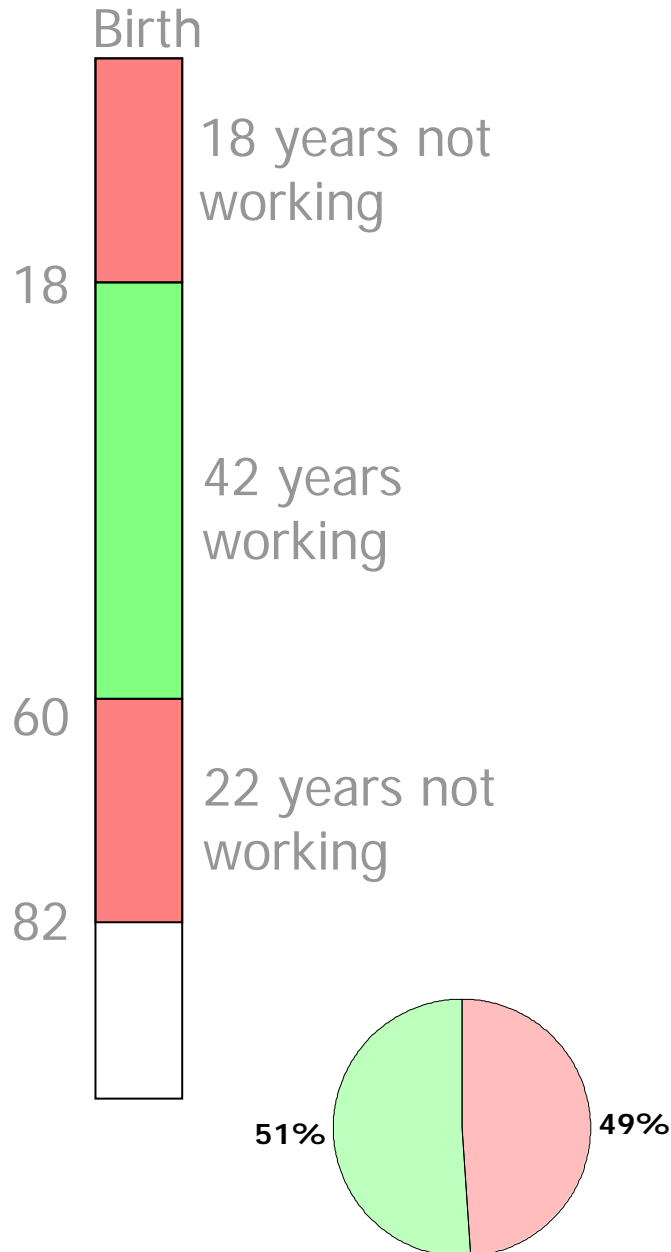
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- MUST RETHINK RETIREMENT!
- Retirement lasting too long – meant to be 5 years or so
- Waste of resources - paying people not to work
  - Long-term economic decline, huge rise in poverty
- Age discrimination legislation - business must accept it
- Retirement a 'journey' not a 'destination'
- Pensions Commission proposed raising state pension age  
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- ?Re-think retirement - new phase of life, part-time work?

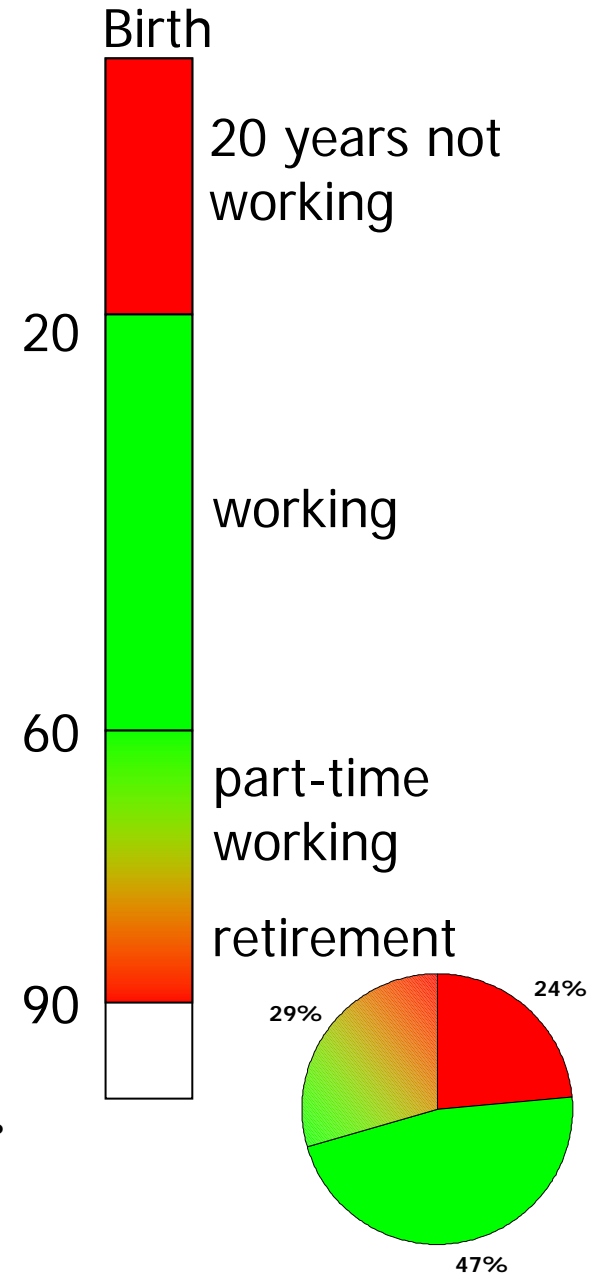
# 1950's



# Now



# Flexible Working





# Rethinking retirement

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- New phase of life we never had before
- Cut down gradually - part-time working, job sharing
- 2-3 days working, 4-5 days off
- More leisure and more money to enjoy the leisure
- Good for individuals and employers
- Good for the economy



# Summary

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- Separate state and private pensions – can't reform private pensions without state reform and retirement change
  - State provide basic social welfare
  - Individuals responsible for extra either savings/part-time work
- Proper and fair savings incentives for all
- Bring pensions **and retirement** into 21<sup>st</sup> Century
- Strong political messages – new phase of life, fair for all
  - HIGHER STATE PENSION
  - DEAL EFFECTIVELY WITH POVERTY
  - FAIRER SYSTEM – WOMEN ENTITLED IN THEIR OWN RIGHT
  - NEW PHASE OF LIFE WAITING



# Radical rethink of pensions & retirement

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New thinking for the 21<sup>st</sup> Century

THANK YOU FOR LISTENING! LET'S TALK...

Dr. Ros Altmann

[ros@rosaltmann.com](mailto:ros@rosaltmann.com)

