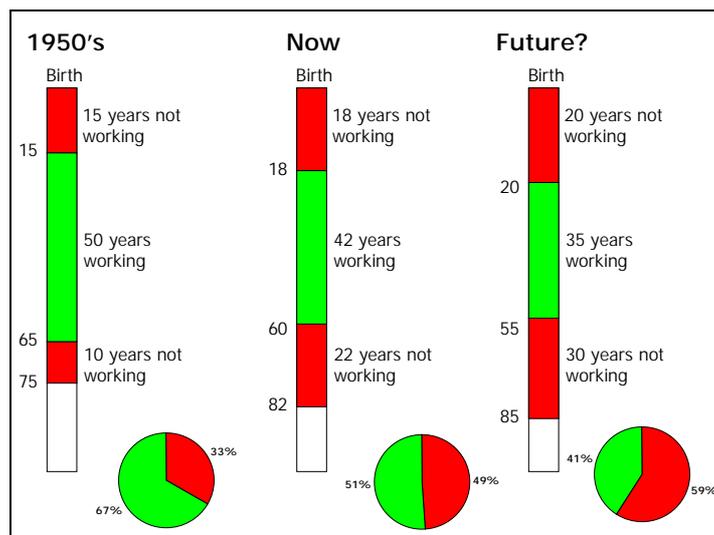


CHANGING THE CONCEPT OF RETIREMENT
Pensions can only do so much...

Pensions are hitting the headlines as never before. The press is full of stories of a 'pensions crisis'. In December 2002, Government released its long-awaited Pensions Green Paper, aiming to identify the changes required to improve our pensions system and address the demographic problems facing our economy. The Green Paper proposals covered two main areas. Firstly, pensions and secondly, retirement. On the issue of pensions, the proposals were disappointing. No new incentives for pension provision, even more consultation on previously proposed measures, but some welcome simplification on the tax side. On the issue of retirement, however, the proposals are much more useful and could make a meaningful contribution to alleviating the longer-term funding strains associated with supporting increasing numbers of pensioners. The measures will make it easier for people to work longer. This does not have to mean 'work till you drop', but could herald the start of a system of gradual retirement and more flexible working patterns at older ages. Retirement should become a 'process' rather than an 'event', in which people can choose to cut down their working hours gradually over time. This is much healthier for individuals, better for the economy and can help address the pensions crisis too.

The fundamental problem with pensions today is that they are having to last too long. They were never designed to pay-out over 30 or 40 years. Current policies for retirement and pensions were devised over half a century ago and our policy framework has fallen significantly behind the beneficial trends of increased longevity and improved health. Universal State pensions and National Insurance were introduced many decades ago. In those days, people would typically stay at school until age 15, work till 65 and then live for another 10 years or so. This meant they spent approximately two-thirds of their lives working full-time and the other third not working at all.

Times have changed. People are often staying on at school until age 18 nowadays, then working until around 60 (the upper retirement age for the public sector) and less than a third of men are still working by age 65. Therefore, most are spending only about half their lives in the labour market. As for the future, if individuals, after increasingly staying on in higher education, are hoping to retire in their 50's, and longevity continues to increase, they would spend only 40% of their lives working. The following chart illustrates these trends.



This situation is unsustainable and will, inevitably, harm long term growth. If individuals are contributing to the economy for fewer years, output and living standards will decline. How will these increasing numbers of older people be able to afford a decent standard of living without working? Can

pensions be expected to support them for this length of time? Someone who starts contributing to a pension in their mid-20's and retires in their mid-50's, will have contributed for 30 years. If they live into their 90's, these 30 years' of contributions will need to last for 40 more years.

If private sources of income are not sufficient, people will fall back on State support. But State pension payments are not rising in line with earnings, which implies that increasing numbers of people will have to rely on means tested benefits in old age. This is worrying. Individuals will have lower incomes and, as numbers of older citizens increase, there will be significant strains on public finances as the elderly demand higher payments.

By 2050, the number of older people in the UK is forecast to increase by 50%. This, coupled with falling numbers of younger people, poses a potentially serious problem for employers too. There is a strong probability of labour shortages developing. In particular, the demographic profile is expected to deteriorate rapidly in around 20 years time.

One answer, therefore, must be to encourage people to work for longer, to maintain their income levels better, to be less of a burden on the State and to contribute more to the economy, thus improving economic performance. This strand of the Green Paper has much to commend it. But, it is not simply a question of raising the State pension age from 65 to 70. Survey evidence clearly shows that people are not in favour of this. However, enabling people to cut down the amount they work in later life, rather than stop work completely at a particular age, would be much more popular. People do not welcome the 'cliff-edge effect' that we have now, where one day they are working full time and then suddenly they are not working at all. They value the income from work, company of colleagues, feelings of usefulness and structure to their lives. They would be comfortable working longer but at lower stress levels, perhaps part-time, job sharing, mentoring, and so on. This could be combined with improved lifelong learning, to enable individuals to re-train and change jobs more easily, if they want to.

This means changing the way we think about retirement and pensions. Gradual retirement could become a whole new phase of life, that did not exist before. The period after full-time work and before stopping altogether. There could be a flexible band of retirement ages to account for individual differences, with people perhaps living on part pension, if they need extra income.

The Pensions Green Paper has started the debate on these issues. A number of its proposals would address many of the barriers which currently prevent older people from staying in the labour force. At the moment, our labour market and employment laws are not geared up well for this gradual retirement concept. Government's proposals include providing greater flexibility of pension withdrawal, permitting people to take part pension and stay with the same employer, making it less attractive to take early retirement on favourable terms, encouraging companies to create more job opportunities for older workers, age discrimination legislation and improved employment protection rights for older workers. As far as the State pension is concerned, current incentives to delay drawing a pension are not generous enough to make it worthwhile. The Green Paper proposes to increase the rewards for delaying retirement and offer lump sums rather than higher income as an option. This is likely to encourage people to delay retiring.

It will take time for attitudes to change, but workers need to consider retiring at much later ages. It may seem difficult to envisage this actually happening. Will companies welcome the idea of employing older workers on a part-time basis, and will people be happy to work into their 70's? Several trials are already underway and there is clear evidence that such changes can have significant advantages. Employers report many benefits of an age diverse workforce and employees are enjoying staying at work. Employment of working mothers sets a useful precedent for such employment shifts, especially as the extent of manual labour declines and service sector employment increases. A couple of decades ago, it was generally thought that employers would not be willing to employ mothers with young children, but this has been managed relatively easily, with job-sharing, part-time work, flexible

work patterns and so on. Which suggests it can be done for older workers too. This will be a very positive social change. Many of those retiring in their 50's, when still young and relatively healthy, are likely to become bored after a while. Unless they have high incomes to support them in comfortable lifestyles, the idea of continuing to work, but not full-time, should be welcomed.

The optimal combination of savings and work will be different for each person. People should be enabled to choose how much they can afford not to work as they get older. With gradual retirement, pension costs could be greatly reduced. Occupational schemes would become less onerous for companies to fund, and the financing of today's exceedingly generous pensions would be more manageable.

In summary, pensions and retirement policy has lagged too far behind the changes in demography and health status during the past half century. Current expectations about early retirement and large pensions are unrealistic and socially wasteful. Policy needs to move into the 21st Century.