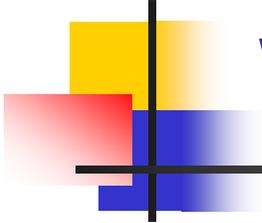


The Role of Government in Pensions

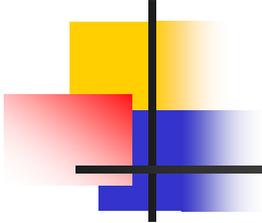
SOFA Conference
23rd November 2004

Dr. Ros Altmann



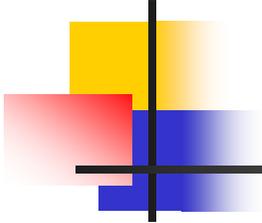
Why do we need Pensions?

- Social:
 - Support those 'too old' to work – prevent absolute poverty
 - Ageing population – long term economic decline
- Economic:
 - 'Reward' long working life
 - Provide long term investment capital
- Personal:
 - Lock savings away while working – deferred pay
- Political:
 - 'grey vote', pensioner numbers to rise from 11m to >15m



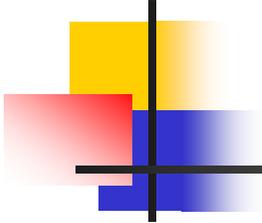
Government Role in Pensions

- If State ensures the elderly have above poverty line income, why worry about private pensions?
- Should state provide earnings-related pensions?
- Free market, free choice vs. state direction
- Do we need compulsion? Or incentives?
- Funding vs. pay-as-you-go



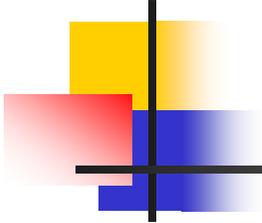
UK Pension Model

- Successive Governments relied on shifting pension burden to private sector companies and individuals
- Very low state pension, strong private system
- UK has more private funded pension savings than rest of Europe put together
- Both state and private pensions very complex
- Interaction adds even more complexity
- Emphasis on funded private pensions



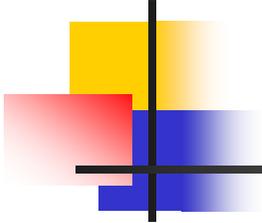
UK State Pension System

1. Basic State Pension +
 2. Earnings related (SERPS/S2P) +
 3. Means tested pension credit (targeting on majority!)
- Compulsion through National Insurance
 - Can opt out of SERPS/S2P – contracting out nightmare
 - Bewildering complexity



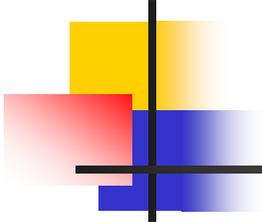
UK Private Pension System

- Occupational defined benefit
- Occupational defined contribution
- Personal Pensions
- Stakeholder Pensions
- SIPPs, SSASs, EPB, Section 32
- Bewildering complexity



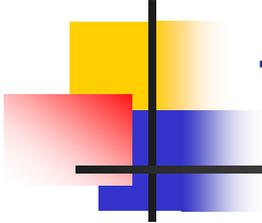
Europe Pension Models

- High earnings-related state pensions
- Inter-generational solidarity
- Pay-as-you-go
- Much less reliance on private funded pensions



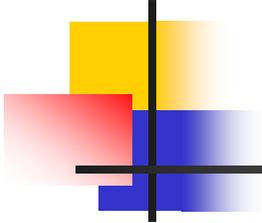
Both Models Breaking Down

- Ageing population
- Early retirement plus rising longevity
- Generous pensions unaffordable
- Europe must cut state pensions and increase private
- UK must increase state pensions as private cover falls



UK State Pension lowest and falling further

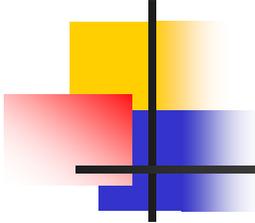
<u>Country</u>	<u>approx. % of final pay</u> (for someone retiring on average earnings)
Germany	40.5
France	49.5
Italy	81.5
Netherlands	58.0
Spain	92.0
Sweden	52.0
UK	29.5



State Pension Spending % GDP

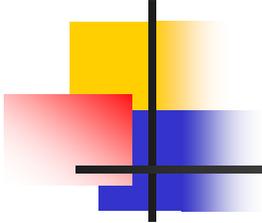
<u>Country</u>	<u>2000</u>	<u>2020</u>	<u>2040</u>
■ France	12.4	15.0	15.8
■ Germany	11.8	12.6	16.6
■ Italy	13.8	14.8	15.7
■ Spain	9.4	9.9	16.0
■ Sweden	9.0	10.7	11.4
■ UK	5.5	4.9	5.0
■ EU Average	10.4	11.5	13.6

Source: Economic Policy Committee, EU working group on ageing populations, 2001



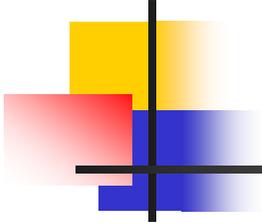
Problems of UK Model

- State pension fallen too far
- Spread of means testing undermines private pensions
- Contracting out not working
- Company scheme deficits
 - – equities/interest rates fall, longevity rising
- Funded -> 'pray-as-you-go'
- Stakeholder/personal pensions confidence - scandals



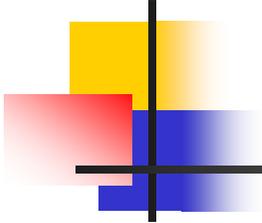
Tremendous Political Opportunity

- Government can say to UK population – ‘we are going to give you much higher pension’!
- This will clear the way for private sector to supplement a basic minimum
- Encourage higher labour force participation
- Europe has political nightmare – ‘we are going to give you much lower state pension’



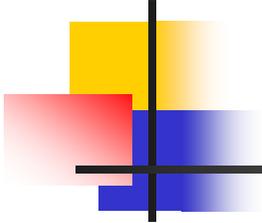
Barriers to Private Pensions

- Pensions now not suitable investment – Pension Credit
- Policy relying on supply side reforms
 - Low charges and simplification not enough
- Target group locked out of advice
- Need to improve *demand* for pensions, not just supply
- Better incentives – for employers and individuals
- Confidence



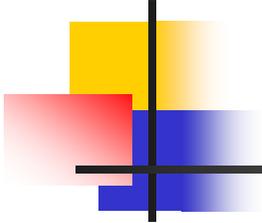
Challenges for UK Government

- Make state pension compatible with private system
- Clarify State system to allow individuals to build on top
- Tackle important issues of move away from final salary
- Better access to advice for mass market
- Ensure money purchase pensions work better



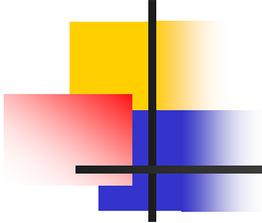
How can we do it?

- Pay £105 pw to all pensioners – no means test
- Basic minimum – if you want more, save
- End contracting out to fund this – no tax rises needed!
- No mass means testing
- Leave private sector free to offer pensions/savings for those who want and can afford more



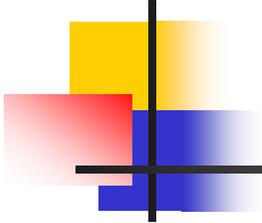
Company Pensions

- Significant shift away from final salary schemes to DC
- Big change – needs to be managed
 - can't just rely on employer any more
- Four crucial areas in DC not working properly
 1. Contributions – being cut
 2. Investment profile – not well structured
 3. Costs too high – individual vs. pooling
 4. Annuities – need advice and reforms



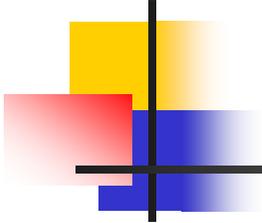
Challenges for Financial Services Industry

- Regain trust
- Simplify procedures, forms, jargon
- Design products attractive to consumers
- Financial planning advice
- Capital guarantees?



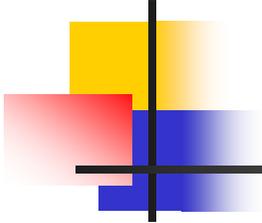
Policy Response - Summary

- Reform State pension system
- Improve incentives
 - higher rate tax relief for all, lottery stakeholder
 - Incentives for employer-provided pensions and advice
- Encourage pooling for economies of scale
 - Advice in workplace
 - People cannot do this on their own, but uneconomic 1by 1
- Lead debate on re-thinking retirement



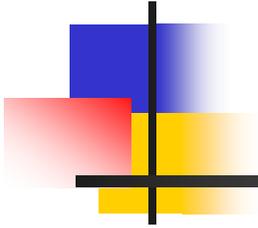
Gradual Retirement

- Change concept of retirement
- 'Journey' not a 'Destination' – 'Process' not an 'Event'
- New phase of life
- Continue earning and contributing, but not full time
- Benefit individual, society and economy
- Old age support more affordable, higher living standard



Conclusions

- Reform State system to provide stable base
- Restore confidence - policy to address demand
- New and better incentives for employers and individuals
- DC structured better
- Make advice process cheaper for mass market



Thank you for listening

Dr. Ros Altmann

www.rosaltmann.com