

Pension Policy Proposals

1. Pension policy has a twofold purpose:
 - a. To alleviate poverty in old age; and
 - b. To create a savings framework to ensure that people are able to save adequately for their old age.
2. The current pensions system in the United Kingdom achieves neither of these two goals effectively.
3. The basic state pension does not provide an adequate income. This is recognised by the government which has put in place a Guarantee Credit, replacing the Minimum Income Guarantee, of £109.45, per week as compared with the current state pension of £82.05 per week and increasingly relies on the benefits system to make up the difference. We consider it absurd that a notionally contributory state system results in a pension which is admitted by the government to be too low to live on. In Wales in particular this has resulted in pensioners being forced out of retirement and into low paying jobs where they rely on benefits to top up low pay because the state pension is inadequate. Only the south-west and north-west of England have comparable numbers of pensioner households on workers tax credit, and they have far larger populations.
4. In addition, because benefits are withdrawn at a high rate over a very modest level of savings there is a substantial disincentive to save for low earners. For example those individuals who receive the full state pension, but also have a small amount of savings which does not take them over the Guarantee Credit will be no better off than those who have not saved at all, since benefits are withdrawn pound for pound. The Savings Credit provided by government provides some additional taper relief from age 65 onwards, but at a high rate of withdrawal. In practice this acts as a substantial deterrent to savings.
5. The increasing reliance on means tested benefits results in very high administration costs.
6. The minimum pension that is consistent with relieving poverty in old age has to be set at the level of the Guarantee Credit or above. We would recommend therefore that a 'citizen's pension' of £110 per week be instituted, to be increased in line with average earnings. This pension would be based on residency, rather than contributions, since it is, in essence, a continuation of the benefit system into old age on a consistent basis. This pension would be payable irrespective of whether or not two recipients lived together as a couple.

7. We recognise that £110 per week would amount to only about 22% of current National Average Earnings, and that this would be low by international standards (in New Zealand the level of the citizen's pension is some 32.5% of NAE), but it would result in a substantial increase in the current state pension.
8. A wider public debate must take place in relation to the funding of a citizen's pension. A citizen's pension at this level would be affordable either by a transfer of pension tax relief, by raising the retirement age in line with increased longevity, by an increase in public expenditure on pensions or a combination of all three. Otherwise the citizen's pension would have to be set at a lower level to be tax neutral. If raising the pension age was considered this should only affect those people at least 15 years from retirement. The greater challenge in this area is to implement policies that ensure that more people are able to remain in paid employment in their fifties and early sixties. An active programme to tackle age discrimination in the workplace is a key element in addressing this issue.
9. Consolidating entitlements to the state second pension (S2P) and the basic state pension, taken together with the increase in retirement age, would not result in a very large increase in the total cost of pension provision in the decades ahead, but it would create a clear, fair and coherent basis for a system designed to ensure that all citizens in retirement have the means to live above the poverty line.
10. A citizen's pension would have the following advantages:
 - a. It would be easy to understand.
 - b. It would be simple and cheap to administer
 - c. It would encourage additional savings, both because citizens would know very clearly what they could expect in retirement and plan accordingly, and because it would be a universal benefit it would not discourage savings in the way the current means tested Guarantee Credit does.
 - d. It would ensure that women, the disabled and those who had suffered periods of unemployment were not disadvantaged
 - e. It would be regarded as a more honest system, by acknowledging that the state pension is concerned with poverty alleviation, and paid out of general taxes, rather than pretending to be some kind of contributory system.
 - f. It would at least ensure that many people who are currently entitled to Guarantee Credit, but do not take it up will also be able to live in dignity in the future.
11. The changes in the state pension system under Margaret Thatcher, particularly the indexation of pensions to price increases rather than

average earnings reduced the cost to government of pension provision over time, but it also undermined public faith in the benefits which they could expect from a state pension system, as the value of the state pension fell further and further behind rising living standards. The current Labour government has exacerbated this mistrust by continuing this discredited approach.

12. The current amalgam of public and private pension schemes to provide an earnings related long term savings framework is also subject to many problems, including:
 - a. The state second pension has historically been subject to a number of changes, resulting in a lack of confidence in the benefits that may be available under it.
 - b. The provisions such as contracting in and contracting out for the state second pension (S2P) have resulted in a system which is not well understood.
 - c. Private sector pensions have suffered from government interference, such as the withdrawal of tax benefits by Gordon Brown when Advanced Corporation Tax was abolished, and the threatened capping of company pension schemes under the Thatcher government. Together with inadequate funding and poor market performance this has resulted in substantial deficits in many large company defined benefit pension schemes.
 - d. Although it is now commonplace to change jobs several times during a career, most company pension schemes are poorly designed to accommodate this, resulting in a number of partial pensions building up on a deferred basis in different schemes when employees do move.
 - e. When companies offer a defined benefit pension scheme it is understandable that they should require employees to contribute to the company scheme, since the company is liable for the underperformance of the assets. However if the company becomes insolvent and the pension scheme is under-funded this can result in employees losing both their jobs and substantial pension rights, and this can be made worse when employees have contracted out their second state pension. With more companies moving to defined contribution schemes it is now employees who are taking the investment risk, and it is open to question whether they should still have to contribute to the company pension scheme to benefit from employer contributions or whether they should be able to request the company to make pension contributions to the pension scheme of their choice.
 - f. As a result of pension fund costs companies are becoming noticeably less generous in their pension fund contributions.

- g. Of the £13 billion of tax relief provided by the government to subsidise pensions, over half goes to 2.5 million higher rate tax payers while the rest goes to 13 million lower rate tax payers, and nine million get no benefit from tax relief at all, since they do not contribute to an additional pension plan.
 - h. For many people outside very large corporate schemes, the administration and marketing costs of pension providers substantially reduce the amount of pension assets accrued.
- 13. Under the terms of the Finance Act 2004 due to come into force in April 2006 it will be possible to accrue on a tax deductible basis a 'pension pot' of up to £1.5 million, and receive tax deductions on income up to £215,000 per year. We believe this is a wholly inappropriate use of scarce state resources and that pension relief must be used in a much more equitable and effective fashion.
- 14. In conjunction with a citizen's pension, there should also be a state sponsored earnings related system. This should be either compulsory or on an automatic enrolment basis (with the potential to opt out) above a certain threshold of earnings until a maximum cap was reached. Since there is a limited ability to save for those on lower incomes, it would not be right to have automatic enrolment for all, but the system would be available on a voluntary basis for those below the lower threshold. For every pound contributed by the individual (or on the individual's behalf by their employer) the government would make a matching contribution, initially on a pound for pound basis and thereafter on a diminishing basis up to a maximum amount.
- 15. The state sponsored scheme would be on a funded basis, and the government would obtain tenders from managers in the fund management industry to be responsible for investing pension contributions.
- 16. Every contributor to the state sponsored scheme would receive once a year a statement showing the amount of savings accrued and a projection of what pension this might produce. This would reinforce the contractual nature of the pension, increase public trust in and comprehension of the system, and increase awareness of the importance of saving for retirement.
- 17. The government would also guarantee a minimum return on the funds contributed by the individual at a level consistent with good financial practice.
- 18. The government's contribution to the state sponsored scheme would be provided by the transfer of the £13 billion of tax relief on pension

payments. The upper and lower thresholds of the state system would be set to make the total cost of the system tax neutral.

19. This would result in a savings system where the lower paid were encouraged to save and where the benefit of the government subsidy to saving was concentrated on those at the lower end of the income scale, with all wage earners benefiting across the spectrum
20. We also believe that it is right that where parents take time out of their careers for raising children then they should receive payments into the pension system based on their previous contributions while in employment.
21. Because of the universal nature of the saving system it would be transferable from job to job, so that there would be no discontinuity of contributions to different schemes.
22. We believe that a state administered pension savings scheme would have the following advantages:
 - a. It would target government assistance for savings where it is most needed, at the lower paid, and not go disproportionately to the higher paid
 - b. It would not be affected by individuals moving from one company to another and would be open to the self employed
 - c. It would be comparatively cheap to operate, thus ensuring that a greater proportion of contributions went to pension payments rather than fees
 - d. It would form a coherent, transparent and easy to comprehend system, where anticipated pension outcome would be provided on a year by year basis
 - e. It would reduce the pension problems of those who take career breaks to bring up children
 - f. It would reinforce good saving habits
 - g. It would remove the credit risk of the private sector from pension provision; employees would not depend on the creditworthiness of their company for pensions under this system, and pension obligations would not destabilise otherwise creditworthy companies
 - h. Individuals would have a level of savings performance for their contributions guaranteed by the state.
 - i. As a result of the above it would restore public confidence in pension saving
23. We believe that the new citizen's pension should be brought in as soon as possible, to alleviate the considerable poverty and distress borne by many people in retirement. It would supersede both the current basic state

pension and the state second pension. Those individuals who would be entitled to receive a higher amount than the citizen's pension through the combination of the basic state pension and the second state pension would continue to receive the higher amount. So for example if a current pensioner, or someone due to retire would be entitled to receive a combined basic state pension of £82.05 and a state second pension of more than £27.95, they would continue to be entitled to receive this higher amount rather than the citizen's pension.

24. A state wide pension system could be brought in within a reasonably short time period in view of the fact that it would be a very simple structure, and the government systems are already in place for a much more complex state wide system.
25. All pension rights accrued up until the introduction of the new system would remain unaffected. Once the new system was introduced the benefits due under the new system would be added to those already accrued under the old system. For company pension schemes, employees would only be required to pay contributions to the state sponsored scheme up to the maximum contribution; this would not be dissimilar to the current second state pension, without the contracting out option. Contributions made to a company pension scheme over and above the contributions to the state sponsored scheme would not be tax deductible.
26. Given its inadequacy and complexity and the disproportionate amount of tax relief provided to higher rate tax payers, the current UK pension system needs to be radically reformed. The work of the first Turner Report in highlighting a number of the key issues is welcome. The reforms made to the pensions systems in Australia and in Sweden point to an effective way of addressing inadequate savings rates among the lower paid on a fair basis. We believe a two tier pension structure, with a citizen's pension and a widely based and simple state sponsored savings system will help in assuring a fair and equitable future for the retired at an affordable cost, and restoring trust in pension provision.