

MEDIA RELEASE
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“Be bold in reforming state pensions” **say pension experts**

The PPI today launches a new report *Shaping a Stable Pensions Solution: How pension experts would reform UK pensions*.

The PPI report brings together the views of around 80 pensions experts from over 40 organisations who, throughout the last 12 months, responded to detailed papers on the critical aspects of pension policy. The aim was to build up a consensus on what a long-term pension solution could look like. The project was funded by the Nuffield Foundation.

This initiative confirmed the case for change and that change has to start with the state pension. Most pension experts believe that the complex state system is not fulfilling the role that only a state system can: to guarantee that all older people have sufficient basic income.

“There is no doubt that every pension expert wants to see change in state pensions”, said Alison O’Connell, Director of the PPI.

“For most pension experts, a better state pension means: a structure that people can understand, providing full benefits to a wider range of individuals and a high enough level of benefit so that means-testing for basic income is reduced.

“Saving for retirement becomes so much clearer if the role of the state winds back from the current complexity of Basic State Pension, earnings-related State Second Pension, Pension Credit and contracting-out to deliver instead a single state pension that provides basic income as simply as possible.

“If the state delivers better on that basic task, the means-testing trap is avoided and so private saving stands a better chance of success. Most pension experts believe that the state should also play a role in promoting saving through tax incentives. Auto-enrolment into savings schemes could help.

“Most people agree with the Pensions Commission’s broad construct of more generous state pension with wider coverage, limiting the growth of means-testing, and anticipating that people will generally work longer.

“But many pension experts would go further. This project suggests that as the Government prepares its White Paper it should be bolder than the Pensions Commission’s proposals. It should:

- Aim to reduce the current extent of means-testing, rather than trying just to stop the spread of means-testing.
- Move quickly to a simple, flat-rate state pension, probably a single-tier, rather than keep an element of earnings-related benefit in the second state pension for decades.
- Find a new, fairer way of giving tax incentives for saving, rather than keeping the current method.”

The PPI report also examines the calls for some kind of standing pensions commission. It concludes that while regular independent review of pension policy could be a good thing, it may not necessarily make policy more stable. Many experts believe that the best way to ensure stability is to have the simplest possible - and therefore most transparent - state pension.

The PPI will publish a further two reports in the next few weeks. One will examine the affordability of simpler alternatives to the Pensions Commission’s proposal for state pension reform. Another will offer ideas on the proposal for a National Pensions Savings Scheme (NPSS).

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A summary of conclusions from the project follows on the next 2 pages.

The report and other papers from the project can be downloaded from:

www.pensionspolicyinstitute.org.uk

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Notes for editors

The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. It does not lobby for any particular issue or reform solution but works to make the pension policy debate better informed.

The Nuffield Foundation is a charitable trust established by Lord Nuffield. Its widest charitable object is ‘the advancement of social well-being’. The Foundation has long had an interest in social welfare and has supported this project to stimulate public discussion and policy development. The views expressed are however those of the authors and not necessarily those of the Foundation.

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Shaping a stable pensions solution:
How pension experts would reform UK pensions
Summary of conclusions

The *Shaping a stable pensions solution* project commenced in Autumn 2004, motivated by a sense in the pensions community that consensus did exist on the need for pension reform. It is now accepted by Government that the pension system should be reformed with a White Paper due to be published in Spring 2006. The Government has also identified that consensus is necessary for a sustainable solution.

Fundamental to getting pension policy on the right track is clarifying the currently confused role of the state in pension provision. The majority view of the experts contributing to this project was that the role of the state in UK pensions should be clearly delineated into two:

- Deliver better on the one role that only the state can do - poverty prevention, and,
- Enable and incentivise the private sector to do what it does best - provide earnings-related pensions on a voluntary basis.

Consistent with this approach, this project identified the general shape of a consensus pensions solution (outlined in the following Box 1):

1. The current state pension system needs to change in order to guarantee against poverty in retirement more effectively.
2. Extensive means-testing forces a number of difficult policy trade-offs and is not sustainable in the long term.
3. Coverage of the state pensions needs to improve, with particular focus on improving gender equality in retirement income.
4. Well encouraged and regulated, voluntary earnings-related provision on top of a reformed state pension could meet the objectives of a compulsory savings scheme.
5. Working longer will play a key part in increasing retirement income.

There is a widespread concern that pension policy, once reformed, should be sustainable and stable over time. To achieve this, many suggestions have been made for some kind of independent permanent pensions commission. While differing in precisely what this might mean, most suggestions aim for some kind of unbiased research and commentary on pension policy trends and choices. But independent review of policy may not guarantee stability if it leads to frequent change of the system. Many experts believe that the best way to ensure stability is to have as simple and transparent a pension system as possible.

Box 1: A consensus view on a pensions solution

- 1. The current state pension system needs to change in order to guarantee against poverty in retirement more effectively.** The primary role of the state has to be to prevent poverty in retirement, as only the state can guarantee this. However, poverty prevention is currently not guaranteed as state pensions are low and there is less than full take-up of Pension Credit. Private pensions will continue to be an important source of retirement income, but the appropriate or realistic balance between state and private will vary from person to person. It is unlikely that the Government will achieve its long-term target of switching the proportion of pension income from 60% state and 40% private to 40% state and 60% private. The "40: 60" measure may be an interesting policy indicator, but the state looks set to remain the majority provider of retirement income.
- 2. Extensive means-testing forces a number of difficult policy trade-offs and is not sustainable in the long term.** Means-testing is an effective short-term method of targeting limited state resources. However, current policy trends show the extent of means-testing will increase significantly in future. This will exacerbate a number of problems, including the public's dislike of means-testing, uncertainty as to how much individuals will receive from the state, and increasing cost. Alternative methods for targeting resources exist which may be more politically acceptable and sustainable in the long term. For example, affluence testing could be explored further.
- 3. Coverage of the state pensions needs to improve, with particular focus on improving gender equality in retirement income.** A residency-based system provides better, gender-neutral coverage, but reforming the current contributory system implies less change and is seen as being less risky. Improvement to women's state pension entitlement is now regarded as central to the pension reform debate. At the very least, improvements need to be made to the design of credits for people not in paid work within the contributory system.
- 4. Well encouraged and regulated, voluntary earnings-related provision on top of a reformed state pension could meet the objectives of a compulsory savings scheme.** The state already enables and incentivises private pension provision. Strengthening this role, for example, with the introduction of a national auto-enrolment scheme, may be preferable to compulsion as a means to reinvigorating voluntary saving. Ways to make the tax relief system simpler and more progressive should also be considered. However, the effectiveness of any such method is likely to be reduced if it is designed to sit on top of the very complicated state system, with people remaining uncertain as to what they will receive from the state. A simpler state system that people can understand and trust could encourage more private saving.
- 5. Working longer will play a key part in increasing retirement income.** In general, people will want to work longer, and the labour market will need to adjust in order to accommodate this. This should include increasing opportunities for flexible, part-time working.