

PRESS RELEASEThursday 20th October 2005**“Broad consensus exists on the objectives of pension reform” says Pensions Policy Institute (PPI)**

A mid-project report finds broad consensus on the objectives of pension reform even if views differ on exactly how to achieve them.

The aim of *Shaping a stable pensions solution*, a project being carried out by the PPI and the Nuffield Foundation, is to build up a picture of a possible consensus for a long-term pension solution.

The following points of consensus among pensions experts has emerged from the series of papers, seminars and debates so far:

- The state is likely to remain the major provider of retirement income as only the state can guarantee poverty prevention. The current system needs to change to do that more effectively.
- Working longer will play a part in increasing retirement income. The key is to make possible the type of work that people want. An increased state pension and a simpler state system less reliant on means-testing should help to overcome many of the current disincentives to save more and work longer.
- Gender equality in retirement income is now a critical part of pension reform.
- The role of the state ought not to stop at poverty prevention. Reinvigorated voluntary saving may be preferable to extending compulsion but there is uncertainty as to whether the state’s role in enabling and incentivising voluntary saving can go far enough.

ENDS

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

For further information please contact -

Alison O’Connell, Director of the PPI on 020 7848 3751 or 07876 566379

email: alison@pensionspolicyinstitute.org.uk

Martin Campbell, Beacon Strategic Communications: 07802 634695

email: martin@beacon.uk.com

Papers and seminar reports can be downloaded from www.pensionspolicyinstitute.org.uk

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, 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.

Shaping a stable pensions solution

Summary of conclusions so far

After four seminars in the series *Shaping a stable pensions solution* it is evident that there is broad consensus on the objectives of pension reform even if views differ on exactly how to achieve them.

1. Both state and private pensions are and will be important sources of retirement income. The Government has a long-term target of switching pension provision from 60% state and 40% private to 40% state and 60% private. However, it looks unlikely that this "40:60" target will be achieved in future. The state is likely to remain the major provider for many people as only the state can guarantee poverty prevention. However, the current system needs to change to do that more effectively.
2. Working longer will play a part in increasing pension income. Current trends look encouraging. The proportion of people older than state pension age in employment has increased from 7.6% in 1996 to 9.8% in 2005. The labour market will need to adjust further to provide more opportunities for older workers. By contrast, saving more seems harder. Just under half of working age people are contributing to private pensions. The level of private saving has not changed a great deal over time, and is expected to decline in future as more occupational schemes change from Defined Benefit to Defined Contribution. A more generous and simpler state system could help overcome many of the current disincentives to saving more and working longer.
3. Gender equality is now a critical part of pension reform. Half of women over state pension age receive the full BSP, compared to 9 out of 10 men. A residency-based system would provide better coverage than the current contributory system and is seen by many to be fair and simple to understand. However, there are concerns that it is too radical, so reforming the current contributory system may seem like the less risky option. More research is needed on what the public think of as 'fair'.
4. The role of the state in poverty prevention needs to be improved, although the state's role ought not to stop here. Reinvigorated voluntary saving may be preferable to extending compulsion but there is uncertainty as to whether the state's role in enabling and incentivising voluntary saving can go far enough.

The fifth seminar, taking place in November 2005, will consider these conclusions in the context of the current means-tested system.

1. What should be the balance between state and private pensions?

Setting the debate

The Government has a long-term target of switching pension provision from 60% state and 40% private to 40% state and 60% private. The distinction between 'state' and 'private' refers to the delivery of the pension rather than the how the pension is paid for. For this target, public sector pensions and contracted-out pensions are counted as being 'private', when in fact they are paid for by the state.

PPI research, based on macro and micro-economic analysis, shows that the "40:60" target does not look likely to be achieved in future. The state is likely to remain the major provider for many people as only the state can guarantee poverty prevention. The balance between state and private pension provision should be as much a social policy decision as an economic one. Such decisions should include the fairness of the pension system, gender equality and individual ability to take on risk.

Points of consensus

- The main role of the state in pension provision should be the prevention of poverty in later life. However, the current system needs to improve to do that more effectively. Poverty prevention is not guaranteed because of imperfect take-up of Pension Credit.
- Both state and private pensions are important, although there are different individual preferences for policy to favour more of one than the other, and different individuals will have different mixes. For example, the appropriate balance between state and private provision can vary from person to person according to earnings levels. It is very unlikely that a low earner would be able to have 60% of their pension income from private sources.
- Working longer is likely to be an important part of resources in later life. The key is to make possible the type of working that people want, for example more part-time and flexible working.
- Growth in the economy is more important for retirement income than the mix of private and public provision. Evidence suggests that the overall resources available to pensioners would be a similar level whatever the mix of state and private provision.

Further debate needed

- Should the "40:60" measure continue to act as the setting for a target outcome, or is it more useful as an indicator of trends over time?

2. How does the interaction of state and private pensions affect incentives to work and save?

Setting the debate

There are different ways to fill the so-called 'savings gap', that is, to maintain current average standards of living for pensioners relative to the rest of society:

- If state spending on pensions is not increased, then reversing the trend of falling private saving **and** working longer would be needed, or,
- A combination of more spending on state pensions and working longer could close the 'gap' even if private saving does fall as predicted.

People are working longer but private pension saving seems to be in decline. The proportion of people older than state pension age in employment has increased from 7.6% in 1996 to 9.8% in 2005. This trend looks likely to continue. By contrast, saving more seems harder. Just under half of working age people are contributing to private pensions. This level has not changed a great deal over time, and is expected to decline in future as more occupational schemes change from Defined Contribution to Defined Benefit. For many people the benefit of saving is not clear.

Incentives to work longer and save more are important parts of the policy mix. However, there are concerns that current incentives are not effective, as they are overly complex and vary in different circumstances.

Points of consensus

- In general, people want to be able to work longer. This is a good thing and should be encouraged through the labour market.
- The state has a role in helping to overcome the disincentives to save more that exist in the current pension system. For example, by limiting the impact of means-testing and pension system complexity.
- With a higher state pension, the state would have to do less to encourage people to save.
- A simpler state system that people trusted and understood would encourage people to engage in making their own decisions about their future retirement income.

Further debate needed

- Should non-pension saving be encouraged, and if so, how?
- How can the current system of regressive tax incentives be redesigned in a practical way to be more effectively targeted?
- How can the labour market adapt to enable people to work longer? For example, people in highly stressful work environments may have to change to different jobs earlier.

3. Should state pensions be universal or contributory?

Setting the debate

It is widely recognised that the state's main role in pension provision, that of poverty prevention, needs to be improved. Recent reform proposals have concentrated on three different ways to improve the Basic State Pension (BSP): improve the coverage, increase its level, and maintain its relative value by indexing in payment to earnings. Reforming just the BSP level and value has less impact if inadequate coverage means that there are people who are still not receiving the full benefit.

The PPI investigated whether the eligibility criterion for the state pension should be on a contributory basis or on a universal basis:

- Under a contributory system, eligibility for state pension is decided by how many National Insurance contributions you have paid or been credited. Partial pension can be paid for less than the full number of years. The work-based nature of the BSP means that low earners, part-time workers and carers are particularly susceptible to receiving less than the full BSP.
- In the universal system, eligibility is determined by how long you have lived in the UK.

The current contributory system could be modernised to better achieve its objectives. However, a universal system has always been considered a feasible alternative and has support as it is simple and inclusive.

Points of consensus

- Improvements to women's state pension income are central to pension reform. At the very least, technical issues such as the design of credits need to be addressed.
- Improving the contributory system through increasing the number of activities qualifying for credits would increase significantly administrative complexity without removing all of the gaps.

Further debate needed

- What are the different meanings of fairness in the context of the first-tier state provision? Should everyone get the same, or should those who contribute be rewarded?
- What does the public think is 'fair'? Public support is cited in support of both contributory and residency-based pensions. Further research into public perceptions of fairness would be helpful.
- What are the advantages and disadvantages of a more radical change to the contributory system? For example, reducing the number of qualifying years used in calculating a pension from 44, to say, 20 years.
- Would a contributory or residency-based pension better protect against political interference?

4. Should earnings-linked pensions be voluntary or compulsory?

Setting the debate

With the future adequacy of pensions in doubt, the debate over whether we should have a compulsory earnings-related pension today has been reinvigorated. But if the state does have a continued role in earnings-related provision, it does not necessarily have to be a compulsory system.

There is a wide range of options for state involvement in earnings-related pensions. At one end of the spectrum, the state could have no involvement at all. At the other end is the original role envisaged for SERPS, where the state delivers an earnings-related pension.

Compulsory earnings-related pensions are becoming less important in the current pension system. Some people support them, but they are expensive and the benefits are disputed.

The debate also raised the question of whether properly encouraged and regulated, voluntary earnings-related provision on top of a reformed state foundation pension scheme might be able to meet the objectives of a compulsory scheme.

Points of consensus

- The role of the state ought not to stop at the poverty prevention first-tier, but should at least extend to encouraging second-tier voluntary pensions.
- Re-invigorated voluntary saving may be preferable to more compulsion but there is uncertainty as to whether the state's role in enabling and incentivising voluntary saving can go far enough.
- It is not at all clear that there is wide support for greater compulsion for second-tier pensions, and in particular compulsory private earnings-related pensions are seen to be problematic.
- The existence of contracting-out complicates the consideration of any policy change to second-tier pensions.

Further debate needed

- How can carers and other people who cannot work be included in a compulsory pension that is based on making contributions through the workplace?
- Can a reinvigorated contracting-out function increase voluntary pension provision? The number of people contracting-out is decreasing and there is uncertainty over the evidence that it is contracting-out as opposed to incentives that encourage saving.