Radical Statistics Briefing Paper

Pensions Policy

by

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Current situation

There are about 11 million people above state pension age (60 for women, 65 for men), representing about 19% of the UK population. The majority of pensioners are women, 63%.

Pension sources – state and private

A longstanding policy has been to keep state pensions low (relative to international levels) and encourage saving through private (occupational or personal) pensions. Although most income is from state pensions, only those with substantial private pensions have a decent standard of living.

Employees may opt out of the state second pension into a private pension. However access to a worthwhile private pension scheme is selective, depending on occupational status. The most generous occupational pension schemes (based on final salary and benefiting from employer contributions) are only available in large organizations, mainly public sector. The majority of occupational pensions are money purchase schemes with little or no contribution from the employer. Individual employees may instead contribute to a personal pension (including a stakeholder pension) but these also attract little or no employer contribution and also incur relatively high administrative and investment charges (up to 1.5% of the fund annually for a stakeholder pension). Both employer-sponsored money purchase schemes and personal pensions invest contributions in a fund and are therefore dependent on the performance of the stock market, exposing the employee to considerable risk of a lower than expected annuity. Thus, among those with private pension income, the amount depends on the type of scheme and timing of annuitisation as well as level and years of pension contributions.

Less than half of women pensioners have any private pension, even after including widows' pensions, and women's amounts are less than men's (Table 1).

Table 1: Private* pensions by (a) marital status and (b) occupational class. Men and women aged 65+, 2001

	a) % receiving		b) Median amount for those with private pension		
	Men %	Women %	Men £/wk	Women £/wk	Women's/Men's %
(a) Marital status:					
Married/cohabiting	74	28	92	34	37%
Single	52	61	65	70	108%
Widowed	70	56	61	46	75%
Divorced/separated	57	36	78	48	62%
(b) Previous occupational class:					
Professional/managerial	90	64	172	95	55%
Intermediate	60	51	84	43	51%
Routine and manual	62	34	50	28	56%
All	71	43	83	44	53%
N	*1474*	*1882*	*891*	*694*	

**occupational or personal pension, including survivor pensions*
Source: Social Trends 2004: 1-14.

The rise in occupational pension scheme membership since the 1950s has increased average pensioner incomes. Personal pensions, introduced in the 1980s, have as yet had little effect. By 2003, the average income for a single pensioner was £9,500pa, or 44% of National Average Earnings (NAE). However, average incomes are misleading because the income distribution is highly skewed, with a small minority having very high incomes. The richest fifth of single pensioners had £19,000pa (87% of NAE) while the poorest fifth had £4,600pa (21% of NAE) (PPI 2003).

Pensioner poverty

Researchers have estimated the income necessary for a basic 'Low Cost but Acceptable' standard of living, based on goods and services deemed necessary by the public. Both the full single basic pension (£84 per week in 2006) and the threshold for means tested benefits (£114 per week) fall well short of this amount.

The pensioner poverty rate as measured officially is high relative to the rest of the EU. In the UK, 25% (about 2.5 million individuals) have incomes below 60% of median national income, with women more likely to be poor than men. Five other EU countries have higher poverty rates than the UK: Cyprus (52%), Ireland (41%), Portugal (30%), Greece and Spain (both 28%) (Zaidi 2006). In official statistics on pensioner poverty, income is recorded for households, adjusted for household size to take account of assumed economies of scale. In these statistics, each individual is assumed to have an equal share of household income, an assumption that underestimates gender differences in individual income.

Inequalities in pension income

The dominant role of private pensions translates relative disadvantage in the labour market – due to gender roles, occupational class and ethnicity - into inequalities in later life income. Women still provide the bulk of unpaid family caring, impacting heavily on their participation in paid work. State pensions (basic and additional) make allowances for family caring commitments, but state pensions are usually insufficient to exceed the scope of means testing. Whereas men can often add substantial amounts to their retirement income through private pensions, women's lower pay and typically interrupted and part time employment restrict their ability to do so (Ginn 2003). Women who raise a family – the majority – face substantial earnings losses. For example, a mid-skilled mother of two is estimated to receive only half the lifetime earnings of a similar childless woman. This severely reduces her ability to build a substantial private pension. Other disadvantaged groups include those in routine and manual occupations, ethnic minorities and the long term sick or disabled.

Table 2: Median gross individual income in pounds per week by (a) marital status, (b) occupational class and (c) age group. Men and women aged 65+, 2001

	Men £/wk	**Women £/wk**	**Women's/Men's %**
(a) Marital status:			
Married/cohabiting	171	56	33
Single	130	109	85
Widowed	144	112	78
Divorced/separated	125	92	74
(b) Occupational class*:			
Professional/managerial	287	148	52
Intermediate	142	99	70
Routine and manual	136	89	65

Source: *Social Trends 2004:* 1-14.

The distribution of pensioner incomes has become more unequal over recent decades, reflecting the cuts in state pensions since 1980, and the rise in private pension income. Between 1979 and 1996, the median net income of the poorest fifth of pensioner couples before housing costs increased by 34 per cent but that of the richest fifth grew by 80 per cent and a similar trend was evident for non-married pensioners. New Labour adopted the main thrust of Conservative pension policy - to promote private provision at the expense of state pensions, but in order to prevent a rise in recorded pensioner poverty, a massive extension of means tested benefits was introduced – Pension Credit. This complex scheme perpetuates the pensions poverty trap in which saving brings little financial advantage, since additional pension saving is effectively taxed at 40% or more.

Means testing – a sustainable policy?

Some 2.6 million pensioners are reliant on Pension Credit, while it is estimated that a further 1.1-1.6 million pensioners (30-38% of those entitled) are not claiming (DWP 2006). Pension Credit has been justified as targeting scarce resources on the poorest pensioners. However, low take-up undermines the effectiveness of this strategy and is evidence of its unpopularity. The process of claiming is seen as complex, intrusive and demeaning. The government seems to accept that low take-up will persist, having set a target of only 75% take-up. The current policy of price-indexing the basic pension while earnings-indexing the threshold for means testing will extend means testing (including benefits triggered by Pension Credit) from the current 50% of pensioners to about 80% by 2050.

Policymakers apparently have no qualms about this way of dealing with pensioner poverty. They are concerned, however, that the prospect of mass means testing in retirement is a disincentive to saving. For individuals, it undermines the logic of saving and for the pensions industry it brings the risk of misselling (and compensations claims). Given the policy aim of increasing private saving, the Pensions Commission was set up in 2004 to 'review the adequacy of private pension saving and advise on policy changes'.

In the period of consultation, a consensus emerged among representative organizations and pension experts that state pensions should be more inclusive of women and indexed to earnings at a higher level in order to reduce means testing. Many have also argued that tax relief on private pensions (costing net £19bn pa and with half the benefit going to the top 10% of earners) should be made less regressive.

The Pensions Commission

The Commission's first report provided a comprehensive analysis of British pensions, including acknowledging women's longstanding pension disadvantage (Pensions Commission 2004). They observed that to cope with an ageing population some combination of four changes is required:

- Increased saving through private pensions
- Increased contributions to National Insurance
- A higher state pension age
- Lower incomes for future pensioners

The second report (2005) recommended:

- Earnings-indexing the basic state pension from 2010 to limit the spread of means testing
- Accelerating the shift of the state second pension to a flat rate pension
- Introducing a defined contribution (private, funded) National Pensions Saving System (NPSS) with auto-enrolment; employee contributions of 4% and compulsory employer contributions of 3% unless the employee opts out. Tax relief would remain unamended.
- Abolishing contracting out, so that private pensions are in addition to the state second pension
- Raising the state pension age from 2020

These changes would leave state pension spending at 4% of GDP, while Pension Credit spending would rise, the total costing 7.5% GDP by 2050.

The proposals represent some improvement on current policy for working age people, since earnings-linking the basic state pension would halt its otherwise projected decline. However, the recommendations fall far short of what is needed to improve women's pensions or to remove the pensions poverty trap, since the full basic state pension would remain at least £25 per week below the means tested minimum. The NPSS would have the advantage over Stakeholder pensions of compelling an employer contribution, albeit at a modest level, and of keeping charges lower (0.3% of the invested fund annually compared with 1.5% for Stakeholder pensions).

Notably, the proposals provide next to nothing for today's pensioners and those approaching retirement, despite the urgent need to reduce poverty and the indignity of means testing.

The White Paper

The government's response has been broadly to accept the Pensions Commission's proposals. In order to make the basic pension more inclusive for those with caring commitments, only 30 years of contributions will be required (currently 39 for women, 44 for men). However, earnings-indexing of the basic state pension will be delayed until 2012 or even 2015, by which time the pension will be worth only 13-14% of National Average Earnings (NAE). Because of this, a large proportion of pensioners will still be eligible for Pension Credit in the future, estimated as 45% by 2020 (PPI 2006). The persistence of widespread means testing into the future renders saving in the NPSS, or any other pension scheme, of dubious value for most workers, since it is impossible for them to know whether they will escape the pensions poverty trap. Current pensioners will gain very little from the White Paper - nothing at all if they die before earnings-indexing begins.

Thus the opportunity for a radical improvement of the UK pension system, by raising the basic pension to above the level of means testing (22% of NAE) and indexing at this level, has been missed. This would have largely removed the need for means testing and would have made saving (and small earnings for pensioners) worthwhile. Compulsion on employers is welcome but NPSS, like Stakeholder pensions and other personal pensions, places the investment risk on individual workers. Unlike a state earnings related additional pension, NPSS will be of unpredictable value because it will depend on stock market returns and annuity rates.

A progressive alternative

To ensure that women and other vulnerable groups have a decent income in retirement, state pensions need to be strengthened. Compared with private pensions, state pensions are inexpensive to administer, are automatically portable across job and career breaks, can protect carers and other vulnerable groups, and (given political will) can provide a predictable income in retirement. We advocate:

- Raising the basic pension at least to 22% of NAE, largely removing means-testing
- Linking to an index of national growth, such as average earnings
- Maintaining a state earnings related pension scheme (with protection for carers) as a fully portable defined benefit alternative to private pensions, for both employees and the self-employed

Raising the necessary resources by:

- Abolishing the Upper Earnings Limit on National Insurance contributions
- Limiting tax relief on private pensions to the standard rate
- Ending rebates for contracting out of state pensions
- Increasing National Insurance Contributions according to increasing life expectancy

Britain is the fourth richest country in the world. In 2006, the National Insurance Fund has a surplus of £34bn, representing about half of annual social security payments. Rising real net incomes of workers mean an increase in NI would be acceptable, especially since the alternative is to pay more into private pensions, with all the risk involved. Better state pensions are affordable.

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