UK Pension Policy: Denying and damaging solidarity

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It has been claimed that state pensions based on the generational solidarity of a Pay-As-You-Go (PAYG) system will place an unfair burden on younger generations, provoking conflict between workers and pensioners (Johnson *et al.* 1989). Private funded pensions, it is argued, would avoid this and should therefore be promoted while state pensions are reduced. The present UK government endorses this strategy 'so that future generations of workers do not bear increasing burdens of taxation as the number of older people increases' (DWP 2002). However, this orthodoxy has been challenged by a number of social policy analysts. For example, Schokkaert and Van Parijs (2003) start from the ethical position that the collective risks arising from population ageing must be fairly shared between generations. They conclude that this is better achieved through state Pay-As-You-Go pension schemes than through private funded pensions.

In the UK, too, shifting the balance of provision further towards the private sector – pension privatization - has been controversial. Private (occupational or personal) pensions are recognized as a useful supplement if state pensions provide a reasonably adequate basic income, as in the Netherlands. But there is widespread concern in the UK at pensioner poverty due to cuts in state pensions and at increasing reliance on means tested social assistance with its disincentives to saving among workers (Brooks et al. 2002; PPI 2004). A successful generational contract, incorporated in UK state pensions for 50 years and assessed as broadly fair between generations (Hills 1995), is seen as increasingly threatened.

Those advocating pension privatization rely on two assumptions that undermine solidarity between generations. The first is that workers are unwilling to make sufficient National Insurance contributions to maintain an adequate level of state pensions – thus denying the

existence of solidarity with older people. The second is that workers can be persuaded to compensate for the diminishing state pensions they can expect at retirement by investing increasing amounts in private pension schemes. To the extent that this occurs among higher paid workers, the generational contract is damaged through crowding out public pensions and helping to legitimate further cuts.

In this paper I critically examine UK pension policy. In the first part, I question whether the shift from state to private pension provision is necessary. In the second, I use official statistics and UK survey data to show that privatization reinforces pensioner poverty and inequality, as well as incurring extra costs and risks for workers. In the third part, evidence of public attitudes to state pensions is considered.

Is pension privatization necessary in Britain?

Population ageing

The UK population is ageing, but there is no 'demographic time bomb' nor state pensions crisis due to ageing. The ratio of those over 65 to those between 15-64 (elderly dependency ratio) rose from 18 per cent in 1960 to 29 per cent in 2000 and is projected to rise to a peak of 48 per cent in 2040 after which the effect of the 1960s baby boom tails off (Bos et al. 1994; Disney and Johnson 2001). Taking a longer view, the number of working age people for each person over state pension age fell from 14 to 3.5 between 1900 and 2000 and is projected to fall to 2.5 in 2040. Thus the projected decline in this age-based support ratio is less steep than in the past. It is also uncertain because it depends on the fertility rate, which is difficult to predict. The support ratio is a very crude measure of the ratio of workers to pensioners, taking no account of rising employment of women, net immigration and likely reversal of the past trend to early exit from the labour force among older workers.

State pension spending

Spending on British state pensions has for some time been among the lowest in the developed world. Yet the Labour government in 1998 planned to reduce spending on state pensions from 4.4 to 3.4 per cent of GDP by 2050, increasing the share of private pensions from 40 to 60 per cent of all pension provision (PPG 1998). Over this period, the cost of the basic and state second pension was projected to fall from £34bn to

£26bn (in 1997 earnings terms) and the amount provided by these state pensions would fall from 37 to 20 per cent of average male earnings. These projections are slightly modified by above-inflation rises in the basic pension in 2001 and 2002 following pressure from trade unionists and pensioners, but there are no plans to continue such rises. Declining state pensions mean that the cost of means tested benefits for pensioners is projected to rise from 1.0 to 2.6 per cent of GDP by 2051 (GAD 2003).

Sustainability of UK state pensions under current policy is assured, as shown by the swelling surplus in the National Insurance (NI) Fund. While workers pay a percentage of their rising earnings into the Fund, benefits are indexed only to prices. The resulting surplus in the Fund grew from nearly £14bn in December 1999 to £23.6bn in 2002, equivalent to 43 per cent of all social security payments (GAD 2003). If NI contributions were not reduced, the Fund would grow to an incredible £3,541bn by 2060. The combined employer/employee NI contribution is 19 per cent of the employee's earnings, but on current policy the required rate to meet PAYG spending will fall to only 15 per cent by 2050 (assuming 2 per cent annual real earnings growth) or to 17 per cent if earnings growth is 1.5 per cent (GAD 2003). Given the growing number of pensioners in coming decades, by 2050 state pension spending per pensioner, relative to GDP, will be only 58 per cent of the level in 2000 unless current policy is changed (DSS 1998: 14). Thus today's workers, instead of facing an intolerable burden of NI contributions, may in future pay less but receive increasingly inadequate state pensions.

Moreover, predictions of a crisis in state pension schemes due to retirement of the baby boom generation ignores rising productivity (Mullan 2000). 'On present trends the worker in 2041 will be the equivalent of more than two workers today' (Catalyst 2002: 10). The NI Fund surplus means that modest improvements in state pensions are immediately affordable without increasing contributions. However, indexing the basic pension to national earnings would require a rise in combined NI contribution rates from 19 per cent to 31 per cent in 2060 (GAD 2000) – an increase for employees from 10 to 15 per cent over 60 years, assuming employee and employer shares remain roughly equal. Although this would represent a substantial rise in contributions, it does not mean workers in 2060 would be worse off than workers in 2000. The Government Actuary commented that due to expected real earnings growth, 'Even with higher contribution rates real net income [of workers]

would still be significantly higher in 2060 than it is now' (GAD 2000: 23). In Table 1, projected changes between 2000 and 2050 are summarised.

Table 1 Changes 2000-2050, projected on the basis of pension policy in 2002

	2000	2050
Age-based support ratio *	3.5	2.5
Spending on state pensions as % of GDP	4.4%	3.4%
Spending on income support for older people, % GDP	1.0%	2.6%
Spending on basic and State Second Pension ^	£34bn	£26bn
Proportion of pensioners' income from private pensions	40%	60%
Basic pension, % of average earnings	15%	7%
Replacement rate for basic plus State Second Pension~	37%	20%
NI Fund net surplus	£24bn	£3541bn"
Combined employer/employee NI, % of earnings	19%	15%>

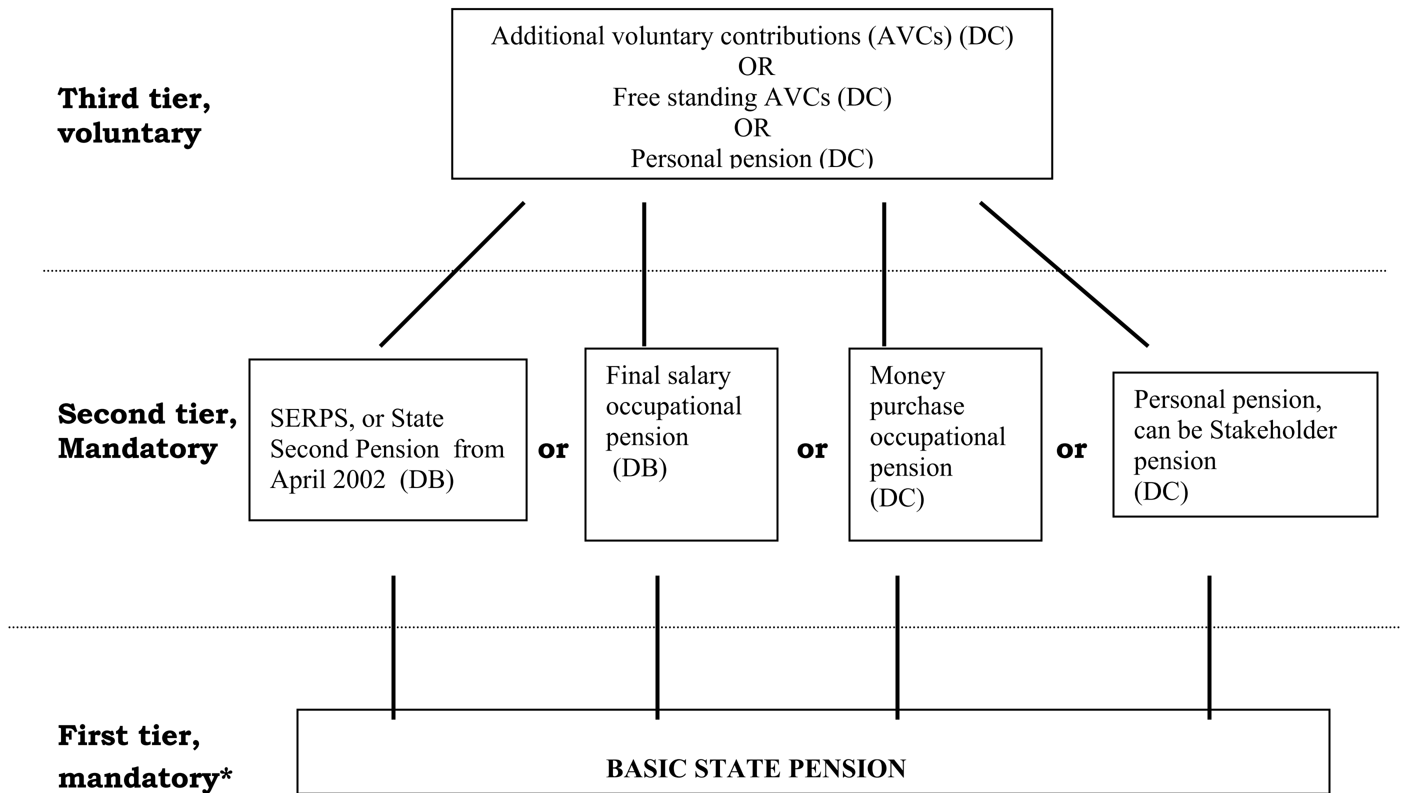
* ratio of working age to pensioner population in 2040
^ in terms of 1997 earnings
~ for a full working life on average earnings
" in 2060
> rate required in 2050 on current policy and assuming annual 2% growth in earnings

That UK state pensions are financially sustainable is widely acknowledged nationally and internationally. But the government's complacency has been met by a growing clamour for improved state pensions to prevent pensioner poverty and reduce income inequalities.

Shifting to private pensions – solution or problem?

With declining state pensions, workers are urged to save more through private pensions. Employees have the option to contract out of the State Second Pension in favour of a private pension (occupational or personal), as shown in Figure 1. Yet good defined benefit (DB) occupational pensions are only available to a privileged (and diminishing) minority of workers. Personal pensions (including stakeholder pensions) based on a defined contribution (DC) are universally available but have drawbacks, in terms of losses due to charges and risk of poor returns (Davies and Ward 1992). Although stakeholder pensions are an improved form of personal pension, that risk is not diminished.

Figure 1 Outline structure of British pension regime, 2002



* Those earning below the Lower Earnings Limit (LEL) pay no National Insurance contributions, but may acquire credits through Home Responsibilities Protection; those earning between the LEL and the Lower Earnings Threshold (LET) acquire NI credits; those earning above the LET must pay NI contributions. For the self-employed, second tier pensions are not compulsory.

The level of risk in private funded pensions was largely ignored until 2000, when the stock market collapsed. Contributors to personal pensions saw their projected pensions fall by around 10 per cent each year after 1999. By spring 2003, the FTSE 100 had fallen to about half its level in 1999. Employees belonging to occupational pension schemes were not immune. By 2000, many final salary schemes had switched to DC plans, with reduced employer contributions and projected pensions some 30 per cent lower than in the original scheme. This places the financial risk on the employee instead of the employer. Some employers have closed their schemes to new members and others have wound up altogether, with disastrous consequences for workers whose expected pension has shrunk overnight to a fraction of its previous level (ACA 2002). Britain was almost unique amongst OECD countries in having no system to protect workers' pensions in the event of business failure or

premature closure and recent legislation to provide compensation is widely considered to be inadequately funded. The lack of legal restraint on companies wishing to cut back their occupational pension schemes has been only belatedly recognised as a problem.

The cost to workers of providing for themselves through private pensions is rising. To obtain a private (DC) pension replacing two thirds of final wages, contributions required have been estimated as 24 per cent of earnings, paid continuously from age 25 to 65 (Mercer 2002). One reason for the high cost of personal pensions is charges for administration, investment management and annuitization. These may reduce the value of contributions by 45 per cent, according to experts (Murthi et al. 2001). An estimated 30-40 per cent of personal pension account holders find that charges actually exceed the amount they have contributed (Disney and Johnson 1997). Thus much of the NI rebate and the tax relief allowed by the government to those contracting out of the state second pension is absorbed by charges levied by pension providers.

For the low paid, especially women with gaps in employment, the private pension option was never a sensible one, as their total pension income would not exceed the threshold for social assistance (Falkingham and Rake 2001). A particular disadvantage for a woman is that DC pensions provide an annuity that is about 10 per cent lower than for a man with a similar fund, due to use of sex-based annuity tables by pension providers. A proposed EU Directive to require sex equality in financial products, including annuities, was endorsed by the European Parliament in March 2004 but has met resistance from member states, particularly Britain.

Private pensions have public costs, although this is hidden from scrutiny, unlike state pension spending. Tax subsidies to private pensions are long-standing but the amount of tax spending grew dramatically under the Thatcher administration, from £1.2bn in 1979 to £8.2bn in 1991 (Wilkinson 1993), reflecting the spread of personal pensions. By 2000 tax spending (not counting the £2bn tax forgone on lump sums from pension schemes) had risen to £13.7bn, equivalent to over 40 per cent of state spending on the basic NI pension (Sinfield 2002). Private pensions tax relief and rebates for contracting out of the State Second Pension cost Britain over 2.5 per cent of GDP in forgone revenue (PPI 2003). Such spending is highly regressive, with half the benefit received by the top 10 per cent of taxpayers and a quarter by the top 2.5 per cent (Agulnik and Legrand 1998).

Generational balance of contributions and receipts historically

The first generation to enter the British public pension scheme in 1948 gained higher returns on their contributions than are available for later cohorts, while all subsequent cohorts are projected to roughly break even in terms of net transfers (Hills 1995). Thus equilibrium was achieved in which each generation paid into NI as workers and received a fair return in retirement. However, the policy of cutting state pensions since 1980 has disturbed this equilibrium. On current policy, the next generation to retire will receive less than they contributed (Hills 1995: 61).

The shrinking basic pension has made it necessary to pay means tested income support to a growing proportion of pensioners. Thus the cost of such benefits is increasing (see Table 1). From 2003, the new Pension Credit introduced a taper into means testing, so that 40 per cent of income above the full basic pension is clawed back instead of 100 per cent as previously. While the taper reduces the marginal tax rate, it also draws over half of pensioners into means-testing and will affect an even larger proportion in future.

The transition entailed in shifting the balance of pension provision from PAYG to funded means that workers are expected to pay both NI contributions and general taxes to support older people, plus extra saving for their own private pension. For those on modest wages or with career breaks and periods of part time work, saving through a private pension will be money wasted, as declining state pensions make it impossible to avoid means testing in later life (Ginn 2003a).

Thus in Britain the principle of generational solidarity promised by contributory state Pay-As-You-Go pensions is being eroded. For the better-off, the declining basic pension is supplemented by private pensions. But for the majority of pensioners a dignified retirement will be replaced by what is widely seen as poor relief, the highly stigmatised form of welfare characteristic of past centuries.

Impact of privatization on pensioner incomes

Prevalence of pensioner poverty

The refusal of successive UK governments to index the basic state pension to national earnings, despite the growing surplus in the NI Fund, has left a relatively high proportion of older people in poverty. The proportion of those over 65 with a household income (adjusted for household size) below 60 per cent of the median for the whole population rose between 1981 and 1991 from 16 to 29 per cent. It fell back to about 20 per cent by 1996 and since then has remained at around this level (ONS 2002). This is higher than the average for EU countries.

The proportion having to rely on means tested income support (IS) indicates the failure of state pensions to provide for basic needs. Table 2 shows receipt of IS among men and women aged over 65 according to marital status and age group in 2001. A fifth of single and widowed women received income support but this proportion was doubled for divorced/separated women. The proportion receiving IS rose with age.

Table 2 Percentage receiving income support (Minimum Income Guarantee) by marital status, occupational class and agegroup. Men and women aged 65+

	All	Men	Women
Marital status:			
Married/cohabiting	3	4	1
Single	17	13	20
Widowed	18	11	20
Divorced/separated	34	23	40
Occupational class*:			
Professional/managerial	3	2	6
Intermediate non-manual	8	11	6
Routine and manual	14	10	18
Age group:			
65-9	6	6	5
70-4	8	6	11
75-9	14	8	18
80-4	15	8	19
85+	18	11	22
All	11	7	13

** Based on own previous occupation*
Source: General Household Survey 2001

Means testing has been justified as targeting resources on the poorest pensioners. However, as many as one third to one quarter of all those who are eligible for the benefit fail to claim it (DWP 2003a), so that this strategy is ineffective. The process of claiming is seen as complex, intrusive and demeaning. 'The main barriers to claiming related to fears of appearing in need, losing independence and a feeling that people could manage on their own resources' (McConaghy et al. 2003: 2). Whereas pensioners see NI pensions, to which they have contributed all their lives, as an entitlement they have earned and can accept with dignity, claiming means tested benefits is considered by many to signify shameful dependency. Yet many British pensioners, especially women, need IS mainly because the basic pension provides an increasingly inadequate income.

The UK emphasis on private pensions has led to growing income inequality among pensioners, which is examined next.

Inequality of pensioner incomes

The distribution of incomes among pensioners is profoundly influenced by private pensions. Whereas state pensions are redistributive, especially in making some compensation for unpaid caring work that has restricted employment, private pensions transmit labour market disadvantage into low pension income. Women, with their greater reliance on state pensions, are the main losers from the growing privatization of pensions.

The relative contribution of private pensions, state pensions and other state benefits to older people's total income varies with a range of characteristics, including their age. Private pensions contribute 30 per cent of the income of those aged 65-74, but this falls to 24 per cent among those aged over 85. In contrast, state pensions contribute 35 per cent of income between ages 65-74, rising to 46 per cent among those aged over 85 (ONS 2003).

Median individual income of those aged over 65 varies with marital status, previous occupational class and age group. Among men, those who were married have the highest income. However, among women the never married and widowed have the highest income (Table 3). The precarious financial position of older divorced women is evident; although their income was higher than that of married women, they have

no prospect of inheriting a widow's pension. Incomes also varied with previous occupational class.

Table 3 Median gross individual income in pounds per week by marital status, occupational class and agegroup. Men and women aged 65+

	Men £/wk	Women £/wk	Women's/Men's %
Marital status:			
Married/cohabiting	171	56	33
Single	130	109	85
Widowed	144	112	78
Divorced/separated	125	92	74
Occupational class*:			
Professional/managerial	287	148	52
Intermediate non-manual	142	99	70
Routine and manual	136	89	65
Age group			
65-9	177	90	51
70-4	168	92	55
75-9	148	92	62
80-4	143	93	65
85+	123	92	75
All	161	92	57
N	*1474*	*1882*	

**Based on own previous occupation*
Source: General Household Survey 2001

These differences in older people's incomes reflect mainly inequalities in their ability to build private pension entitlements during the working life (Arber and Ginn, 1991; Ginn and Arber, 1993; Ginn, 2003b). For women, domestic roles reduce their years of employment, lifetime earnings and access to occupational pensions. Similarly, manual workers are less able than non-manual to build good private pensions. The effect of earlier work roles on state pensions is less severe, due to their redistributive features, yet low and declining state pensions in Britain mean that an adequate retirement income increasingly depends on having a substantial private pension.

Table 4 Private^ pensions by marital status and occupational class. Men and women aged 65+

	a) % receiving		b) Median amount for those with private pension		
	Men	Women	Men	Women	Women's/Men's
	%		£/wk		%
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%
Occupational class*:					
Professional/managerial	90	64	172	95	55%
Intermediate non-manual	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
** Based on own previous occupation*
Source: General Household Survey 2001

Table 4 shows the proportions receiving private pensions among men and women aged 65 and over (a) and the median amounts for those with this source of income (b). Only two fifths of older women had any private pension income, including widows' pensions based on their deceased husbands' private pensions, compared with over 70 per cent of men (Table 4a). A high proportion, 61 per cent, of single women had some private pension income and their median amount was high (£70 per week) relative to ever-married women and to widowers and single men. Divorced women's low total income (Table 3) reflects the fact that only a third had any private pension income and the low median amount at £48 per week.

The distribution of pensioner incomes has become less equal over recent decades. 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 (DWP, 2003b). Goodman et al. (2003) calculate that the Gini coefficient for pensioner incomes after housing costs increased from 0.25 to 0.35 between 1979 and 1991 and has subsequently remained at around 0.34, indicating considerably higher income inequality than in the past. Because women have been less able

than men to compensate for declining state pensions, through private sector pensions, the gender gap in pensioners' personal incomes has widened. In the mid-1980s older women's median personal income was 71 per cent of men's, declining to 62 per cent in 1993-4 and to only 53 per cent in 1998 (Ginn, 2003b).

Tackling poverty and income inequality among pensioners requires better state pensions, yet policymakers seem to believe that spending more on state pensions would be unpopular. Given the ideological shift in policy towards the welfare state since 1980, it is worth examining whether the public shared policymakers' views.

Public attitudes to state pensions

Public support for state pensions, as indicated by the British Social Attitudes Surveys, remained strong throughout the period of major reforms to the pension system. From 1983, when Conservative cuts in welfare were beginning to bite, through to 1995, the proportion of the public agreeing that the government should increase taxes and spend more on welfare nearly doubled from 32 per cent to 61 per cent. Less than 5 per cent throughout this period wanted lower taxation and welfare cuts, while the remainder wanted taxation and spending to remain the same (Lipsey 1994; Taylor-Gooby 1995; Brook et al. 1996). This shift in public attitudes towards more support for state welfare applied irrespective of political affiliation or age group. Between 1983 and 1994, the proportion who thought those on high incomes paid too little tax increased from a third to over half (Taylor-Gooby 1995).

Pensions are the most widely supported type of social security benefit. Of five benefits on which extra spending might be made (pensions, disability, children, unemployment, single parents) pensions were chosen as a priority by the highest proportion, 68 per cent (Brook et al. 1996). Over three-quarters of the UK population thought a pensioner couple who lived solely on the state pension would be poor or hard up and a similar proportion thought the government should spend more on pensions. A question asked in 1997 showed 68 per cent of men and 76 per cent of women thought the government should definitely be responsible for providing a decent standard of living for the old (Taylor-Gooby 1998) and by the year 2000 the proportion had increased to 80 per cent (Hills 2001).

Responses to a variety of questions, over a period of more than a decade of welfare retrenchment, show that public attitudes to welfare in the UK ‘seem obstinately to resist conforming to the dominant policy themes’ (Taylor-Gooby 1998: 71) and instead resemble those of people in other European societies. Hills (2001) concludes that the Labour government underestimated the popularity of pensions. Their policy of limiting basic pension rises to prices and extending means testing was not supported: ‘People thought the government was failing in its responsibility to provide a decent standard of living in retirement’ (Hills 2001: 25).

Conclusions

Solidarity between generations, expressed through state Pay-As-You-Go pensions, has been under attack in the UK since the 1980s from neo-liberal ideology, in which individuals are assumed to be responsive only to immediate economic self-interest. The policy of reducing public PAYG pensions and promoting the private sector of pensions has contributed to growing income inequality in later life, left too many pensioners in poverty and brought dependency on means testing among pensioners to unprecedented levels. It has been costly for workers, individualizing pension risk and increasing total pension contributions without any certainty of a commensurate increase in the expected pension. It has escalated spending on tax relief, most of which has been siphoned away from workers to pay pension providers’ fees, so that only the highest earners benefit substantially. Pension privatization has also had the perverse effect of disrupting a previously stable generational contract.

A preference among policymakers for private pensions persists, despite their vulnerability to pressure from demographic change, as well as to market risk. Glennerster (1999: 10) asks; 'Given these risks, why is the government so keen to see a continuing shift to private pensions?' The question remains unanswered, since no convincing case has been made for the advantages of the private sector in terms of delivering pensions.

It is a paradox that Britain, where population ageing is relatively gentle and the National Insurance Fund is in surplus, has implemented the most severe retrenchment and the most vigorous promotion of private pensions. Some social policy analysts argue that a crisis in state pensions has been socially constructed in order to present a political choice as an economic imperative (Walker, 1990; Vincent 1999). According to these writers, an ideological opposition to public welfare by neo-liberal governments, rather than economic reasons or unsustainable costs of

public pensions, has motivated welfare retrenchment: 'Political ideology has distorted and amplified the macroeconomic consequences of population ageing in order to legitimate anti-welfare policies' (Walker, 1990: 377).

Since the mid-1980s, UK governments have engaged in a ‘rhetoric of responsibility’ in which contributing to a private pension was portrayed as responsible behaviour while relying on state pensions was associated with a morally inferior status. Despite exposure to this rhetoric, and to policies that undermine confidence in state pensions, intergenerational solidarity among the public remains strong in the UK, so far.

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