Third time lucky?

The 'third consensus' in post-war UK pensions policy

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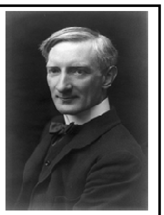
Contents

- The first consensus (and its unravelling)
- The second consensus (and its unravelling)

- The third consensus:
  - Main features
  - The good news
  - The bad news
  - How to radicalise the third consensus

Based on original Touchstone paper co-authored with Nigel Stanley

The first consensus



- 'Collective provision' based on social insurance and social wage
- Contributory and redistributive state pension system
- Employers voluntarily provided defined benefit (DB) pension schemes
- Not inclusive for those outside labour market
- State stepped in to replicate DB as labour market expanded (SERPS and contracting) out, but messy and expensive

The first unravelling

- Social and economic change 'stretched' the first consensus
- Growing power of business to abdicate traditional welfare role
- Perception of 'state overload' (longevity?)
- Regulation (member protections in response to crisis) or deregulation (contribution holidays)?
- Financial services growth and expanding defined contribution provision

The second consensus

- 'Individualised' pensions
- Value of both state pensions eroded, and fewer employers offering DB (or any) private pension
- Growth of means-tested benefits as pensioners became poorer and poorer, state re-cast as 'safety net'
- Labour increased value of safety net and sought to widen access to DC pensions

The second unravelling

- Never a strong consensus
- Individual behaviour did not change quickly enough, and economy did not grow strongly enough, to make DC pensions viable
- DC pensions marred by mis-selling
- Basic contradictions: savings disincentive of safety net, and employer malevolence in a flexible labour market

The third consensus

- ‘Market-shaping’; based on Turner Commission in mid-2000s
- Move towards flat-rate state pension, taking everyone above poverty threshold
- State pensions system re-cast as a savings platform
- Auto-enrolment in private pension with minimum employer contributions
- NEST scheme to set benchmark for private pensions industry

The good news: state pensions

- Coalition govt gone further than Turner in proposing single tier state pension
- Designed to end means-testing and complexity
- Provides certainty for retirement planning
- Will immediately offer more to those without good S2P provision, or PC non-claimants

The bad news: state pensions

- Very low starting rate, lower than promised
- Single-tier does not achieve simplification; greater reliance on complex private pensions
- Millions still dependent on CTB and HB - and PC if they miss just one year
- Messy contracting out legacy (as Turner recognised)
- Fails to incentivise private saving (greater % at risk)
- Majority retiring after 15-20 years better off before

More bad news…

- Single tier accompanied by accelerated rise in **state pension age**
- Policy-makers (and statisticians) ignore inconvenient fact of life expectancy inequalities
- By 2028, white-collar men will receive 17.6% more lifetime state pension than blue-collar, 20.4% for women
- East Dorset pensioners will receive around 50% more than Manchester men and Corby women

The good news: private pensions

- Establishes employer duty to contribute
- Many employers (especially SMEs, low-paid workforces) will use trustworthy and low-cost NEST scheme

The bad news: private pensions

- Dominance of DC, individualisation of risk
- It gets worse: contract-based DC, reflecting inappropriate faith in financial services. Fundamentally contradicts inertia model
- (Yet there are governance problems with trust-based DC too, both big and small)
- Possibility of high charges – although not a large problem going forward
- Endemic problem of hidden transaction costs – failure to challenge City practices

More bad news…

- Low employer contributions, especially initially, and many low-earners now excluded
- Insane reliance on annuities for retirement income (rip-offs and complexity)
- DC schemes not good for long-term 'real economy' investment

Radicalising the third consensus: 1) Single tier reform

- Third consensus has progressive potential and capacity to sustain wide support – need to act within broad model design
- Higher single-tier starting rate
- Alternatively, phase in higher rate through additional indexation

2) Contributions and tax relief

- 8% is a myth: due to phasing, earnings band, trigger, tax relief
- Contributions from the first £ of pay
- 'Third Time Lucky' paper suggested contribution rate could be temporarily lowered to fund lower earnings threshold, targeting higher contributions on low earners
- Benefits of pensions tax relief heavily skewed to higher earners – they do not pay it back. Need single rate of 30%

3) Governance

- Mandate all employers (perhaps below a certain size) to choose trust-based scheme
- Use automatic transfer system to establish 'super trusts'
- Trustees must be licenced, genuinely independent from providers, and include member representatives

4) Decumulation

- State is the archetypal longevity risk-hedger – it should provide annuities
- (Turner had wanted 'personal accounts' to be entirely state-run)
- Alternative is 'collective defined contribution'; many advantages (eg. more efficient and real economy investment model), but also enables 'self-annuitisation'
- CDC also a way to reintroduce risk-sharing elements of DB

5) Commission for SPA

- Rising SPA based on flawed average LE data, let alone ignoring evidence on LE inequality
- Recent decision on 68 even pre-empted input of government's own actuaries
- Need independent commission with trade union representatives
- Need a lot more data, especially on socio-economic group and/or income distribution
- Guided by life expectancy of lowest income decile
- Must consider evidence on working in later life (conventional wisdom is wrong, skewed by lower female SPA)
- Less frequent than every parliament