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A CATALYST WORKING PAPER

Plugging the gap

How employers can help to fill the pension deficit

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Published in June 2005 by

Catalyst
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ISBN 1 904508 15 4

Distributed by
Central Books
99 Wallis Road,
London E9 5LN
Telephone 020 8986 4854

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Acknowledgements

I would like to thank Lucinda Platt, Adair Turner, Diane Elson, Anthony King and others present at the Vice-Chancellor's Seminar at the University of Essex, 8 March 2004 for helpful comments on an earlier draft. I would also like to thank Rodney Bickerstaffe and all those who contributed to the lively discussion following my delivery of the Norman Melbourne and Barry Amiel Memorial Lecture in London on 13 July 2004, where I drew on the ideas presented here. The foregoing are not, of course, responsible for any mistakes or the particular conclusions I reach.

Executive summary

- The Pension Commission has argued that, if present trends continue, there will be a shortfall in pension provision equivalent to 4 per cent of GDP by 2050. The government has signalled that it is no longer committed to the strategy it elaborated in 1998 and it has called for a debate on the measures necessary to ensure the long-run adequacy of retirement provision. This paper is a contribution to that debate.

- The failure in prospective pension provision stems from a combination of a very modest and declining Basic State Pension; the knowledge that means testing discourages saving; the allocation of the lion's share of tax relief to the richest 10 per cent of tax payers; and the structural flaws of existing private provision, including high charges, low coverage, and the risk and inflexibility that arise in occupational schemes guaranteed by a single employer.

- There is no "free lunch" solution. Increased life expectancy will not lead to longer working lives because of the need for longer periods spent in education and a widespread demand for more free time. Immigrants can help a bit but will not transform the profile of an ageing society because they soon adopt the fertility and life expectancy of the host population.

- There is a growing consensus on the need to strengthen the State Pension and to devise better-targeted incentives to save. The poverty which still afflicts today's pensioners, especially many older women, could be overcome by introducing a Citizen's Pension, to be paid regardless of contribution record or means tests.

- But there remains the problem of covering future pension shortfalls, finding new resources for pension provision and encouraging better levels of saving. The key to solving the pension crisis is to restore the employers' contribution to pension funding, as the TUC has proposed.

- The best way to restore the employers' contribution is to adapt the share levy proposal developed by Rudolf Meidner, the former chief economist to the Sweden's main trade union federation. The issuing of new shares to Pension Reserve Funds calculated at 10 per cent of profits annually would set up a claim on future dividends without subtracting from the cash-flow needed for current investment.

- A twenty-six year accumulation period would enable the Pension Reserve Funds to supply a new layer of provision to all. It is calculated that the total Reserve Funds would be worth £1 trillion by 2031 and that it would generate an income of £40 billion annually, equivalent to about 2 per cent of GDP.

- While the Pension Reserve Fund would plug more than half of the pension gap, other contributions would come from ending the existing, highly regressive form of tax relief on pension saving, and cutting excessive costs in the financial services industry.

1
Introduction

We live in an ageing society with a woefully inadequate pension regime. We lack convincing ways of addressing the future needs of a rapidly increasing population of over-60s and over-80s.

The state pension is miserable, the attempt to give extra help to the needy has extended means tests to more than a half of the retired. Occupational and personal pensions are plagued by many difficulties and, despite a large tax relief subsidy, are bad at turning contributions into pensions.

With a growing elderly population things will get worse. The proportion of the population over 60 did not change much between 1980 and 2000, and the stock market grew impressively over the same period. These circumstances did not furnish a stiff test of the adequacy of the pension regime – but the results were still disappointing, with problems of coverage, excessive cost and insecurity.

The future will be far more demanding.

2

The need to think big

The Pension Commission has estimated that pensions will need to absorb between 16.1 and 17.5 per cent of GDP by 2050 if individual pensioners are not to fall behind the rise in national prosperity and if current employment patterns are maintained.

The pensionable age for women is set to rise to be equal to that of men by 2020. If women's average retirement age rises until it is the same as that of men by 2050 then the proportion of GDP needed to sustain pensioner incomes will be 13.9 per cent if they are not to fall behind rising average incomes. The Commission estimates that current pension provision, both public and private, will supply only between 9.8 and 10.3 per cent of GDP. On even the optimistic assumption concerning older women's employment levels this still leaves a shortfall in aggregate pension provision of about 4 per cent of GDP (1). In today's terms 4 per cent of GDP is about £50 billion, by 2050 it would be at least £100 billion and could well be £150 billion.

There is a need to "think big" when it comes to pensions because we are talking of the livelihood of so many people, with those over sixty comprising a third of the population by mid-century and those over 80 more than doubling in number over that period. While it is very helpful to have the Commission's estimate for 2050, the shortfall will set in long before and could easily be over 3 per cent of GDP by 2031, even with the optimistic projection of older women's future employment levels.

Calculating future pension needs

After a lull in the 1980s and 1990s, the ageing effect is set to intensify in Britain over the next three decades, after which there will be a more gently rising plateau. This is partly because the famous postwar baby-boomers will retire over the next three decades but also because the new, higher levels of the elderly in the population will thereafter be maintained, because longevity is increasing and fertility quite low.

The Government Actuaries Department (GAD) has issued new projections which tell us that those over 60 will rise from 12.3 million in 2002, comprising 21 per cent of the total population, to 19.4 million in 2031, comprising 30 per cent of the then total. The GAD have recently raised the projected life expectancy of 60 year olds by eighteen months. Life expectancy at birth will rise from today's 75.9 years to 81 years by 2031. Low birth rates make as great a contribution to the ageing effect as does increased longevity. The GAD estimates that women born after 1985 will have an average of 1.74 children compared with an average of 2.45 children for women born in the 1930s. In 2002 the average age of the population was 39.3 years; in 2031 it will be 43.6 years and by 2050 45 years. In 2002 there were 3.35 persons of working age for every person of pensionable age; this ratio will drop to 2.5 by 2031 and 2.2 by 2050 (2).

The average age of retirement for women workers today is 60 years, and for male workers 62 years. Women can claim the State Pension today at 60 but, as noted above, this will rise by stages to reach the male pension age of 65 years by 2020. If this new pension age doesn't change then 24 per cent of the population will qualify by 2031. At that time 9 per cent of the total population will be over 80 years old, compared with 4 per cent today. At present nearly one third of adults between 50 and the state pension age are outside employment, with most claiming either a disability benefit or income support. Let us assume – optimistically – that by 2031 the average age of withdrawal from the workforce will rise from 61 to 65, with early retirement balanced by those who work on into their late sixties. If that is achieved, then by 2031 24 per cent of the population will be looking to public and private pension provision to sustain their income.

At present pensioner incomes are around 73 per cent of average per capita disposable income. To maintain the same ratio and prevent a drop in pensioners' relative standard of living Britain's various programmes of pension provision will have to generate pensions worth about 14 per cent of GDP by 2031(3). And because the baby-boomers will have largely retired by that date the likely pension deficit in that year will already be mounting towards the figure for 2050 and could well be over 3 per cent of GDP.

The shortfall appears because of the meanness of the projected state pensions combined with the weaknesses of private provision. The inadequacy of arrangements for the paying of future pensions – whether public or private – is already clear and, unless something is done, will generate steadily rising pensioner poverty.

The projected state contribution

In 1998 the government, in its Green Paper *A New Contract for Welfare: Partnership in Pensions*, aimed to reduce the overall public contribution to retirement incomes because it believed that private pension provision could be re-designed to supply 60 per cent of needed pensioner incomes by 2050 (4). The Basic State Pension, indexed to prices not earnings, was set to decline over coming decades but the needy were to benefit from means-tested supplements. Subsequent government legislation has followed the strategy set out in 1998, though the setting up of the Pension Commission signals a willingness to consider new approaches.

In 2003 government spending on State Pensions, the State Second Pension and on means tested benefits such as Pension Credit, totalled 4.8 per cent of GDP. The Basic State Pension is set to decline from 3.8 per cent of GDP today to 2.9 per cent by 2031 and 2.1 per cent by 2051. The State Second Pension, the residue of the State Earnings-Related Pension (SERPS), and the Minimum Guaranteed Income (MIG) were to raise state support for pensioners from 4.8 per cent in 2000 to 4.6 per cent in 2031 and 4.1 per cent in 2051. Because the MIG was means tested some warned that it would penalise those with modest savings or pension entitlement. The government responded by introducing the Pension Credit, actually a complex benefit taper that leaves many pensioners still paying a high marginal tax rate. The Pension Credit involves means-testing those who apply for it but with results that allow them to keep more of their income from small savings than did the MIG.

It is difficult to know exactly what impact the Pension Credit will have – so far take up has been little more than a half of those who might qualify – but the Department of Work and Pensions (DWP) in its Green Paper on the topic forecast that it might boost public pension expenditure to 4.7 per cent in 2031 and 4.8 per cent in 2051. Pricewaterhouse-Coopers, assuming a higher future take-up, has raised the estimate so that government income support to the elderly rises to 5.3 per cent of GDP (5). However to project endlessly into the future the value of annual winter fuel payments, and free TV licences to the over 75s, seems a little unreal. The Pension Commission argues that public support for pensioner incomes is further raised by Housing Benefit and Council Tax Benefit, since many pensioners qualify for these. Even with account taken of such benefits overall government support for pensioners who comprise just under a quarter of the population will total no more than 6 per cent of GDP by 2031, rising to 6.9 per cent of GDP by 2050.

The projected private contribution

Staying with the earlier target figure that pensioners should receive about 14 per cent of GDP by 2031, and bearing in mind that the government's original aim that 60 per cent of this should come from private and occupational schemes, we see that occupational and personal pensions would have had to supply 8 per cent of GDP by 2031 and as much as 10 per cent of GDP by 2051, most of which would come from investment income from shares, bonds and other assets. The closure of so many "Defined Benefit" or "Final Salary" occupational schemes, the steadily declining contribution made by employers, the poor take-up of Stakeholder pensions and the weak performance of personal pension plans completely rule out the achievement of such a target. Since private pension income was to have come almost entirely from shares and bonds then the target was anyway quite unrealistic (6).

At the present time private pension provision is worth no more than 2 per cent of GDP. With the retirement of the baby-boomers the yield from private schemes will rise – the Pension Commission estimates that, on current trends, private and occupational schemes will supply between 3.4 per cent and 4.2 per cent of GDP by 2050. But this still leaves a large shortfall and the Commission argues that at least 9 million adults are saving less than is required to ensure an adequate pension. Some of the over-65s will continue earning and their income will also make a contribution of around 1 per cent of GDP. In the years 2031-60 and beyond each year is thus likely to see a deficit of 3-4 per cent of GDP or more.

3

The inadequacy of state provision

The hoped-for level of overall provision could be made a little less daunting by raising rather than lowering the contribution of public pensions. Indeed there is an overwhelming case for immediately tackling the survival of pensioner poverty among older pensioners, especially older women, by removing all contribution conditions on the Basic State Pension and raising the latter to the level of the Minimum Guaranteed Income.

Today's pensions are unequally distributed with much scope for raising the incomes of the poorest and some scope for curtailing subsidies enjoyed by the wealthiest. In 2001-2 the median income of the poorest fifth of pensioner couples was £155 a week, or £77.50 each, from all sources, while the median income of single pensioners was £87 a week. The next fifth of pensioner couples received median incomes of £203, or £101.50 each, while single pensioners received £120. For some reason we tend to "think small" – in weekly amounts, as with children's pocket money – when it comes to pensions. These figures meant that the poorer two fifths of pensioners were getting by on c. £4-6,000 a year (7). Even those in the middle had less than £7,000 a year. The single pensioner applying for the Pension Credit should now be entitled to a minimum of £5,309, with many at or close to this level.

The pensioners most likely to be in poverty are women, especially if divorced or separated from their husbands – 40 per cent of divorced or separated women over 65 were receiving income support in 2001-2, compared with 23 per cent of divorced or separated men over 65 (8). Historical pension entitlement, whether public or private, was based on formal employment, and took no account of the huge amount of unpaid labour performed by women in domestic settings. In future the Second State Pension will offer modest credits for those with registered family responsibilities but this will scarcely match the huge contribution made by women of all ages to the care of children, elderly relatives and infirm spouses (9). One half of British women of pension age do not receive the full State Pension, mean as this is compared with public pensions elsewhere. If they fill in a complex and inquisitive form they can qualify for the Pension Credit but many who would meet the criteria fail to apply. Many older persons, especially women, will collect their Basic State Pension but are deterred by the means tests.

Female pensioners are not properly covered by the state pension arrangements but their share of private and occupational provision is even weaker. Only 43 per cent of female pensioners have private provision and those with it receive an average of only £44 a week from it. Together with weaker state provision this leads to a situation where the median income of female pensioners from all sources was only £92 a week in 2001-2 (10).

Nearly a quarter of all pensioners fall below the poverty level and a similar number are only just above it. Is this better understood as a poverty problem, a gender problem, or a pension problem? Of course it is all three. As noted above, primary pension provision reflects prior income and employment, or the lack thereof. Both public and private entitlements are based on contribution records, which is why women who have had casual or part-time jobs, or have spent time out of waged employment caring for the young or old, do so badly. If there was less inequality and insecurity in the world of employment, and if women had equal pay, this would be good for savings and future pensions. But we would still need better designed pension provision, beginning with a Citizen's Pension, paid regardless of contribution record or means.

The British State Pension is currently worth only 15 per cent of average earnings and is still scheduled to decline to less than 10 per cent over the next thirty years. The Pension Credit, the means-tested supplement, raises this to about 21 per cent of average earnings today, and will be pegged to earnings not prices.

However, as we have seen, the British government has yet formally to abandon its goal that state payments will make a steadily declining contribution to retirement income in coming decades. This policy was laid out in Partnership in Pensions in 1998 and it informed legislation in the following year, including provision for so-called Stakeholder pensions. The aim here was to combine a means-tested safety net with a belief that those not enrolled in an occupational scheme could be persuaded to take out a Stakeholder or similar personal pension plan. Despite the fact that employers are obliged to offer Stakeholders to their employees the take up has not been strong – it reached 1.6 million by the end of 2003 – and many of those who have a Stakeholder are not the previously uncovered and/or low paid at whom the programme was aimed. In 2000-1 47 per cent of employees were enrolled in an occupational scheme and 12 per cent had a personal pension plan. Only 2 per cent of the self-employed had an occupational scheme while 44 per cent had a personal plan (11). If those outside the labour force are taken into account then barely half the adult population have private pension coverage.

4

The failings of the private sector

We know that the quality of private pension coverage is very uneven and that outside the public sector occupational schemes rarely offer the possibility of anything approaching full working life membership.

Employers' broken promises

Job mobility means that many millions are dragging around a nominal pension entitlement that will not stand the test of time, because it was small, weakly indexed, not fully vested or vulnerable to "sponsor risk" – that is the risk that the sponsor would fall to bankruptcy or take-over.

For those who stick to the scheme until retirement the "Defined Benefit" (DB) approach should be much the best. But employers too often try to wriggle out of the pension promises they have made. This is especially unjust where employees have accepted a demanding or moderately paid job because it offered a good occupational pension scheme.

The government itself sets a bad example when it tries to cut the benefit in unfunded public sector schemes, for example by raising the retirement age from 60 to 65. If the government wishes to persuade these employees to work longer it could offer a premium wage to those willing to do so. But if employees wish to retire at the age originally promised by the scheme they should be allowed to do so. It should be borne in mind that lower-paid workers in the public service have a shorter average life expectancy, and often started work soon after leaving school. The resources should be found to honour the promises embodied in these schemes, both because pension promises should not be broken and because this will help to meet future pension needs.

It might be thought that private sector Defined Benefit (DB) schemes are much better placed because they are funded. However there can still be major drawbacks. The pension promise is guaranteed only by the sponsoring company, which can get into difficulties, become the victim of a take-over, or go bust. The pension fund becomes an awkward appendage, sometimes an asset, sometimes a liability. Notwithstanding the recovery in share prices the estimated pension deficit of the major DB funds was £85 billion at the beginning of 2005. In July 2004 the collapse of Federal Mogul, a car parts supplier with a heavy deficit in its pension fund, slashed in half the pension entitlement of 20,000 workers and led to smaller losses for another 20,000 in an associated business (12). Employees can sometimes lose entitlement when their company is sold or restructured (about 60,000 have lost out in this way in the UK over the last couple of years). In times past corporate raiders specialised in what was called "asset-stripping". Today "liability-shedding" adds a new dimension to this strategy, as when the chief assets of the Allders retail chain were separated from its pension liabilities, leaving the pension fund with a much-weakened guarantor.

The DB pension scheme often grows to be more valuable than the company which sponsors it. This is fine until it goes into deficit. When a large fund tail begins to wag the corporate dog this can be bad for all employees. The company is forced to mend deficits in its pension scheme rather than invest in the business, with a consequent loss of good jobs. This has happened at Rolls Royce, Corus, ICI, GKN and a host of famous UK companies. It contributed to the loss of 2.5 million jobs in the United States in 2001-3, at companies like Verizon and Maytag, and throughout the US steel industry (13).

The 2004 Pension Bill introduced an insurance scheme whereby companies must in future pay into a Pension Protection Fund. which will guarantee reduced payment levels to members of such schemes. The government has promised £400 million over twenty years to help prime this scheme but this is widely thought to be only a half of what is needed (14). John Ralfe, a pension consultant, warns that contributions will either be affordable to companies but have too little resources or it will have enough resources but demand a level of contribution which will eat into company investment plans (15). The US equivalent, the Pension Benefit Guaranty Corporation (PBGC), was $21 billion in the red at the close of 2004; members of schemes it has insured usually suffer considerable reductions in the pay-out they will receive.

The traditional DB schemes at least aimed to give priority to pensions, and to link the benefit to final salary. In recent years thousands of these schemes have been frozen or wound up, with employees invited to join "Defined Contribution" (DC) schemes instead. In a DC scheme the pension paid is simply what can be purchased by the money in the pot. Employer contributions have plummeted. Employers often used to contribute 12 per cent-16 per cent of salary to DB schemes but usually opt for a much more modest 3-6 per cent for today's DC schemes. DC schemes place the market risk on the employee not the employer. The collapse of the share bubble in 2000-2 and the secular decline in annuity rates have undercut personal pension plans of all types. Company sponsored DC schemes sometimes have good cost ratios. Personal plans are more expensive and not immune to problems of supplier failure.

The personal plan "cost disease"

Personal pension plans continue to suffer from a "cost disease", stemming from heavy marketing, the expense of customising provision to scattered individuals, and the scope given to a host of laxly-invigilated financial intermediaries, each of whom take their cut.

For a century and a half British Chancellors have given generous tax breaks to those investing in pensions – these foregone taxes were £19 billion a year, or about 1.9 per cent of GDP, in 2001-2. The saver will eventually receive 25 per cent of their "pot" as a tax-free lump sum, the remainder being taxed at a lower rate in retirement than it would have been while the recipient was earning – so that the net tax relief is £13 billion (16). The industry itself absorbs some of this subsidy in its bloated cost structure. The incentives are heavily weighted in favour of those paying at the upper tax rate of 40 per cent. Those on average or below average earnings, paying tax at 22 per cent or less, have far less incentive to invest in a personal pension plan. As it is the richest 10 per cent of tax payers garner 51 per cent of all tax relief on pensions (17).

The smaller plans of the lower paid will also be more heavily eroded by commission and charges than the larger savings pots of higher earners, reflecting returns to scale in personal plans, the better paid workers' access to low cost schemes and the start-up fees charged by independent financial advisers.

There is a further reason why pension plans have limited appeal for those not in an occupational scheme. Personal indebtedness in Britain is now running at about 130 per cent of annual disposal income. Anyone servicing a credit card debt or a mortgage endowment policy should pay down their debt, if they can, rather than buy an inefficient pension product. Those who don't own a home will often feel that this has priority over a pension plan and those without a car may feel that buying one would improve their employment prospects. Financial experts and advisers are prone to lament the ignorance or short-term horizons of those who fail to take up personal pension plans. But it could be that they have a better grasp of the matter than the experts. Research shows that fund charges reduce investment yields in pension plans by around 30-45 per cent (18). The Stakeholder charge – recently raised to 1.5 per cent in the hope of persuading commercial suppliers to market this product – will reduce the eventual pot by about 30 per cent over forty years. It is not usually noted that this one per cent charge does not include the commission and renewal fees charged by Independent Financial Advisers. And the eventual pension that any given pot can buy has been nearly halved by the collapse of annuity rates over the last decade. These various reductions in yield nullify or absorb the modest tax relief which those earning less than £30,000 can claim.

Those who are members of a good occupational scheme, or who finance a personal plan from earnings of over £40,000 over a lengthy period, are quite well served by the UK's existing pension regime. Most of those in the top quintile of incomes, and many in the next richest quintile, can expect to replace at least a half of their former salary (bringing them well above 70 per cent of average income).

However, as we know, it is not plain sailing even for the middle class pensioner, whether member of an occupational scheme or beneficiary of a personal pension plan. The collapse of Equitable Life, affecting nearly a million savers, and the shortfalls faced by many "with profits" plans illustrate the danger. The memory of the pension mis-selling scandal of the 1980s and 1990s, affecting three million pensioners, highlighted a cost burden that has not disappeared.

British pension funds of all types are worth about £950 billion – equivalent to about 90 per cent of GDP – and the fund managers have annual expense ratios equivalent to about 2 per cent of their assets. If we add in the costs of consultants and custodians, the invisible charges involved in "soft commissions", together with the fees charged by Independent Financial advisers, overall expenses in the sector amount to at least 2 per cent of GDP (19). In a funded system there is, of course, no connection between incomings and outgoings at any given time, though in a mature system with good investment growth one might expect the latter gradually to overtake the former. Yet when we examine the private sector contribution to actual pensioner incomes it seems to punch below its weight. According to new, downwardly-revised figures, the pensions industry takes in £52 billion annually in contributions (20). Its receipts are something like 4.5 per cent of GDP (21). Yet it pays out only 2 per cent in pensions. While the demography of unequal cohorts partly explains this – the baby boomers are still in the labour force – the costs generated by the financial services industry weaken the returns. (In the wake of the recent mutual fund scandals in the US John Bogle, former CEO of Vanguard, complained that that total costs of this component of the US savings industry were around $130 billion annually, or 1.3 per cent of US GDP, a figure he thought needlessly inflated (22). A root problem is what the economists call information asymmetry between supplier and customer – the complexity of financial products means that the former is much better informed than the latter.

While it would be easy to enlarge upon the problems presented by the private savings industry – and also to show how the pension fund regime fosters irresponsible investment styles (churning bubbles, rapid trading, short termism, herding, indulgence of poor governance and so forth (23)) – I would like instead to return to the large problem set out at the beginning: How can we meet a dramatically larger pension bill? I would first like briefly to consider policies and developments which some wrongly believe solve the problem at a stroke.

5
Weak solutions and the illusion of the cheap fix

The pension shortfall will best be tackled by a various and radical package of measures, as we will see. We should be on our guard against illusory cheap fixes, such as raising the pension age to 70, reliance on immigration, or the "release" of housing equity to take the strain.

By the time we discover that these expedients are weak or undesirable more pensioners will be plunged in poverty and it will be very hard to make up lost ground.

Raising the retirement age

There is certainly scope for raising the effective age of retirement by voluntary means (i.e. without further raising the state pension age). If discrimination was seriously tackled then many more 50-65 year olds would be able to get employment and many over-65s would decide to stay on. Bringing the average age of withdrawal from the labour market up to 65 would itself be a major achievement. Those who qualify for the state pension can continue in work, and either defer it (obtaining a better future pension) or add it to their earnings. This allows the older worker to maintain income but take a less demanding job.

But raising the state pension age – as the CBI, the employers' organisation, proposes (24) – would be unfair to manual workers and support staff, who have significantly lower life expectancy at 65 than professionals and senior managers. Moreover they will often have entered the labour force at a younger age than the latter, so their lengthier contributions period will be coupled with curtailed entitlement. If the state pension age is raised and many older persons fail to get a job, or apply for a disability benefit, then the savings made in state pension outlays will be counter-balanced by increased benefit expenditure. Simply shifting the cost from pensions to some other branch of social insurance would be an illusory saving.

Because people stay fitter for longer, and if ageism can be tackled, there is scope for raising the number of years the over-60s work. But the gain here will be partly counter-balanced by the need to allow for the fact that the time spent in education and retraining is increasing and will continue to do so. Dependency ratios calculated on entry into the labour market at the age of 16 are no longer realistic. The government itself plans that a half of each age cohort should in future receive higher education. In the learning society, there will also be spells of further education at later ages. Even if those who study are increasingly obliged to pay for it themselves, they will still not be able to contribute much to pension provision – either their own or anyone else's – during these times.

Increasing immigration

The ageing effect can be somewhat reduced by immigration, though existing GAD projections already assume a net inflow of 130,000 a year. Over the course of three or four decades rising immigration has only a mild impact on dependency ratios because the immigrants also have parents, whom they bring over or send money to. The immigrants have fewer children and they, too, begin living longer, all factors conducive to the ageing society. Using immigration as the chief or only way to boost the size of the workforce soon begins to raise population levels to implausible heights. If Britain was to keep the same ratio of workers to pensioners then it would need to raise the population to 136 million by 2050, which would generate huge infrastructure costs (25).

Liberalising immigration is desirable but there is a moral consideration which should further limit its impact on pension finance. The immigrants accepted by liberalising regimes came from poorer societies, who have paid for the migrants' upbringing and education. It would be wrong for rich societies to plan to meet their pension problems by draining poorer societies of skilled and youthful workers while rejecting the aged and infirm.

Raising the birth rate

Because the birth rate slump has contributed to the ageing of the population, any reversal in this trend would increase future labour supply and, hence, taxes. But the decline in family size has everywhere been a concomitant of prosperity. Britain's birth rate is about average for the developed countries and is accompanied by what the mothers' describe as unwanted births, which official policy seeks to avoid.

The measures likely to boost wanted births include better child-care facilities, greater parental leave and shorter and more flexible hours of work – the introduction of the 35 hour week in France has coincided with a jump in the birth rate. These policies are desirable in themselves. While they might eventually boost the productive population a little they would also demand real resources. They will yield a gain in the quality of life rather than major resources for pension provision. We should bear in mind that spells of "dependency", whether in youth, old age or in between, are part of the human condition.

Releasing housing equity

With house prices booming, some look to release of the equity value tied up in the family home as a providential answer to pension problems. Once the children have left, many parents find they can trade down to a cheaper dwelling, using the surplus to boost their pension wealth.

This species of equity release already occurs and has not availed much for the large number of pensioners living on modest incomes. Those who own valuable houses often have pension wealth anyway, while those who lack good pension coverage often have little housing wealth. Because "equity release" schemes can so easily give openings to unscrupulous property developers they should only be allowed, if at all, with rigorous safeguards. Older people are often reluctant to move simply to realise equity when this means leaving a neighbourhood where they have friends and family. Finally, and obviously, we cannot assume that the exorbitant property prices of recent times will still be available in 2031.

6
A decent Citizen’s Pension

If these approaches still leave us with most of the pension deficit to meet where should we look instead? Should we raise NI contributions or general taxes in order to fix the pension provision problem? I believe there is some scope for this, especially in tackling pensioner poverty, but this wont go very far towards raising the target 14 per cent of GDP.

There is an overwhelming case for improving the Basic State Pension. Public pension provision is low cost and has a high take up rate. The Basic State Pension should be paid to all citizens regardless of contribution record. The government has helped to create – in reaction to its own policies – an extraordinary consensus that the Basic Pension should be dramatically improved, embracing the Conservative Party, the Trades Union Congress (TUC), the House of Lord’s select economic committee, the IPPR (a centre left think tank), Age Concern, the National Pensioners Convention and many others. Even the CBI advocates a higher State Pension, albeit paid only from the age of seventy.

Financing better pensions

An improved Basic State Pension indexed to earnings could largely be financed by boosting the NIC by one per cent of earnings across the income range. Gordon Brown won public support for such a rise in 2002 by tying it to increased health spending; boosting the Basic Pension would enjoy similar legitimacy (26).

However I think it would be wrong and counter-productive to believe that the wider pension problem should be tackled by further raising what are, in effect, payroll taxes. If the pension gap was mainly to be filled by this method it would mean doubling National Insurance contribution rates. This would take a big bite out of demand, with deflationary consequences, and sharply raise the cost of employment.

In continental Europe, where payroll taxes add a 40 per cent wedge to wages, this has contributed to an overall pattern of low demand, low growth and high unemployment. The general level of employment amongst those of working age has lagged some fifteen points below the UK or US figure. These countries have some enviable social arrangements – shorter working hours and long holidays, for example. Pension provision is much more generous than in Britain or the United States, as is unemployment benefit. But this does not mean that these countries have found the best way of financing their pension and welfare arrangements. Where payroll taxes alone are used to pay for all social expenditure – rather than being just one major source – the results are deflationary and inegalitarian (27).

Sweden alone has managed to combine good benefits with relatively low unemployment but this was because the founders of its welfare state avoided excessive reliance on pay-as-you-go when funding second pensions.

There is some scope for raising income tax, perhaps by creating a higher band above £100,000 a year. But there are many public programmes which need better funding – child care, education, health – and so pensions could not be the sole beneficiary. It would be desirable, if it is possible, to find sources of pension finance which do not subtract from what is available for, say, public investment in the learning society or tackling child poverty.

As it happens there are, as I hope to show, potential sources of finance for future post-retirement income which meet this demanding criterion. Reaching a level of provision even approaching the overall target of 14 per cent of GDP requires more than a decent Basic State Pension, desirable as that is. It points to a reorganisation of the principles of non-state pension provision, with a dramatic widening of coverage of secondary pensions, the discovery of major new sources of pension finance and a stripping out of the many layers of wasteful expenditure on marketing, customisation, soft commissions, and excessive financial intermediation.

7

Restoring the employer's contribution

At the heart of the pension deficit problem is the dramatic decline in the contribution made by employers.

The freezing or closing of Defined Benefit (DB) schemes is a major factor here. More generally corporations practice elaborate tax planning in order to reduce the tax take on their profits. Financial engineering and tax havens are an important part of this story. Of course some companies still make a real effort, as do some public employers. But it is wrong to allow the burden to be borne only by the more public-spirited.

Corporations themselves depend hugely on the great benefits and privileges they receive from their host society. They benefit from public expenditure on health, education and transport. They benefit from law and order. They enjoy many of the advantages of personhood while being shielded by special legal immunities. All these considerations argue for obliging companies to make a significant contribution to the pension deficit problem. Brendan Barber, the General Secretary of the TUC, has rightly urged that companies should be required to do more: "Britain needs a bigger pensions pot and tweaking at the edges of a voluntary system is not going to achieve this."

The TUC is already committed to exploring a compulsory levy on employers for the purposes of boosting retirement income. In its discussion document, Prospects for Pensions (2002), the TUC urged that employers be compelled to contribute to pension funds for their employees. The TUC had other important demands – for an earnings-linked State Pension, for action to help women and the lower paid and for compensation to those trapped in failing schemes – but the call for compulsory employers' contributions represents a new and dramatic proposal.

Across the private sector coverage is weak and/or patchy – because of the centrality of private corporations in today's economy it is here that resources can be mobilised to improve provision across the board. The TUC's proposal concentrates on private employers. It requires them to fund two-thirds of a pension contribution each year starting at just 3 per cent of salary but rising by stages to 10 per cent of salary. Large and medium companies would be encouraged to set up occupational schemes but other employers would make the contribution to an approved scheme such as a stakeholder pension. The low paid would receive a tax credit to assist them to make their share of the contribution (28). In June 2004 the TUC launched a "Pay Up for Pensions" campaign where it calls for "a new occupational settlement based on compulsory contributions from employers" (29).

Concerned to re-establish the general principle of employers' responsibility the TUC has not gone into much further detail.

A different way to pay

It would be best if the new source of finance did not add to labour costs since if it did it would encourage unemployment. A tax or levy on assets rather than income would fit the bill. The best-known examples of such taxes are death duties, or a wealth tax. While these are worth considering they have the drawback that in order not to penalise farmers and small businesses exemption rates have to be set quite high. The resulting loopholes allow for mass evasion by the wealthy. As tax advisers put it such taxes are "optional". Nowhere do they raise as much as 0.5 per cent of GDP.

An alternative type of asset levy was proposed in Sweden in the 1970s and 80s by the LO, the main trade union federation. It is known as the Meidner scheme after the LO's chief economist at that time, Rudolf Meidner. This levy required all public companies to issue new shares equivalent to five per cent of annual profits each year. The method of assessment was similar to that used for calculating corporation tax but it differed from corporation tax in a crucial respect since it did not make demands on cash flow. Meidner originally wanted the levy to comprise 20 per cent of profits each year and the shares issued under the scheme were to be administered by regional boards on which employees were to be well represented. But the business federations raised an outcry and the Social Democratic government both reduced the levy to about 5 per cent and limited the new issue principle (30). Nevertheless the scheme still raised impressive amounts of money. Wound up for ideological reasons by the Swedish Conservatives in 1992, the scheme's public investment boards owned 7 per cent of the country's stock market.

An asset levy could help to plug the pension funding gap without subtracting from companies' cash-flow or investment plans. Companies frequently issue new shares – for example, when they negotiate mergers and acquisitions, or when they award share options to executives. The shares raised by the levy could not be sold for twenty-five years or more. Instead they would be held to generate revenue in the future when it will be needed to furnish pensions. The future revenue would mainly come from dividend income which is far less volatile than share price. For an initial accumulation period earnings could be used to buy other securities, including government bonds. Companies with less than, say, 20 employees would be exempt from the levy. In the case of unquoted private companies the pension board would be allowed to receive contributions in the form of corporate bonds or cash (31).

Recently business concerns in London have themselves urged that share issues have advantages over cash contributions when it comes to charitable giving, as a recent report explains:

> Some of the City's best-known broking firms and the London Stock Exchange have joined forces for a novel charitable fundraising project enabling publicly-listed companies to make donations through new share placements instead of cash … Although the scheme is structured to give companies a non-cash mechanism for charitable donations that does not affect bottom line profits, it will dilute the shares of existing investors and will, therefore, require special resolutions to be passed at annual share-holder meetings. (32)

What I am here proposing is a gentle taxing of shareholdings, and not a voluntary donation to charity. From the corporation's point of view, it should still be preferable to cash. Of course taxes cannot expect to be popular. But it is anomalous that holdings of shares, unlike the homes people live in, attract no direct tax at all.

A public national Reserve Fund, independent of the government of the day, would be the recipient of the new shares and bonds issued under the scheme. Several countries are now setting up Pension Reserve Funds – Ireland and Sweden are cases in point – and there are obviously a variety of ways of arranging for them to meet pension needs. The new reserve could channel assets from the levy to shore up weak areas of existing provision. It could also establish a new regional network of pension funds which would furnish an extra layer of coverage to all. Unlike existing funds, the pension reserve would not be dependent on a specific employer. The fund network should have its own staff and specialists, and its directorate would be answerable to individual contributors and beneficiaries (33). It is a major defect of Britain's current public pension system that it is simply part of Whitehall and lacks an independent staff, such as the US Social Security Administration.

Advantages of the share levy

The Meidner approach could be seen as simply one way of achieving the goal established in the TUC's Prospects for Pensions, which bears some comparison with the Swedish trade union plan. In both cases the aim was to ensure that large corporations shoulder some of the burden of the ageing society. The main difference would seem to be that the TUC is requiring companies to come up with hard cash whereas the Meidner approach allows them to make their contribution in the form of shares or company bonds.

It might seem that the cash contribution would be best, though the pension funds would not keep much in the monetary form but would instead buy shares, bonds and other income-yielding assets. The Meidner method would allow the pension funds to build up a highly diversified sample of company shares and bonds; investment income could be used to diversify out of corporate securities by acquiring government bonds and real estate. Companies might find it easier to contribute in shares or bonds rather than cash, but why allow them to do this? The chief reason, already touched on above, is that a cash contribution will subtract from the resources available for investment whereas the share contribution would not (34). After properly considering the matter employees as well as employers are likely to see this as a significant advantage. In my view the advantages of the levy approach are likely to be so clear to the parties directly involved that the legislation could allow the exact form of the employers' contribution – whether cash or new issues – to be agreed in negotiation with them.

But the further advantage of the Meidner approach is that it obliges us to move away from two negative features of existing occupational schemes, namely their riskiness and limited portability.

Even the best-designed private sector Defined Benefit schemes have been vulnerable to "sponsor risk", as was noted in a previous section. If the sponsoring corporation goes belly-up then employees will lose out. In the past they could lose everything. With the newly-established PPF (Pension Protection Fund, also dubbed the "Partial Protection Fund" by some) the policy holders will receive some compensation but not the full entitlement. Such DB schemes also deliver the best results only to those who stay with the same company until retirement. These schemes link the future pension to "Final Salary". If the last salary paid to the member was a decade or more ago then the pension paid will not reflect subsequent inflation and promotion. Much of the advantage of a Defined Benefit scheme is thereby lost. This is much less of a problem in the public sector because most large scale public service schemes allow for a degree of geographical or institutional mobility. But private sector schemes were often designed to promote "employee retention" and exact a penalty from those who leave prior to retiring age. Given the greater fluidity of today's job market this is a serious drawback. The Meidner-style levy sets up a pension fund and entitlement that is not employer-specific. It would be able to offer full portability.

The advantages of universal secondary provision will certainly be greatest for those – the majority of all employees if part-timers are included – who currently have no such coverage at all. But those who are in private sector occupational or Stakeholder schemes will be keenly concerned to reinforce and improve their entitlement. Students of pension systems, whether public or private, are prone to stress that they are "path dependent", which is to say that once employees or other contributors have built up entitlement in a scheme they will be committed to its continuance (35). In the UK many occupational DB schemes are underfunded, and many have anyway been frozen, or closed to new members. Defined Contribution (DC) schemes, including Stakeholders, have been let down by the stock market. This conjuncture makes it a bit easier to argue for sweeping changes to the pension system. But it still remains necessary to convince those with a stake in existing schemes that their situation will be improved by any proposed changes. In meeting the problem of those with little or no coverage it would be important to retain the support, and improve the situation, of those already covered.

The TUC supports the case for a better State Pension, seeing this as a foundation to build on. Universal supplementary provision could be seen in the same way. Employees in the private sector would be entitled to their fair share of this extra provision, either paid into a supplementary scheme or used to secure and improve their entitlement in any existing occupational scheme. Some shares could go to the proposed new Pension Protection Fund, which is to insure existing DB funds, thus making it possible to reduce cash contributions to this scheme to a level that will cause less strain than the £300-600 million currently in prospect. Another portion could go to strengthen existing DC funds. Help could also be provided to the unfunded public sector schemes, the aim being to make good demonstrable shortfalls not to replace all existing sources of revenue. These schemes might be shielded from the impact of rising longevity by a portion of the revenues generated from the pension reserve trust fund. The remainder of the revenue accruing would be channelled to accountable regional pension boards – either directly elected or composed in part of elected officials – which would offer contributory pensions to all, using residence and citizenship criteria and offering credits to those outside paid employment.

Addressing pension inequality

It would be good if every individual over 30 years of age received an annual estimate of the value of their total pension entitlement and savings. In the 2004 Finance Bill the Chancellor introduced a cap on pension wealth of £1.5 million – beyond which no further tax relief would be available – in order to curb the proliferation of retirement schemes and products which secure tax advantages for the wealthy. While the Inland Revenue say that only 5,000 will be affected by the cap in the first instance, with an extra 1,000 a year thereafter, the CBI, the employers' federation, estimates that 10,000 will be caught in the first year and as many as 600,000 could be affected over forty years (36). Hitherto British savers have been able to claim relief from several different types of savings product at once making it difficult to settle this question in advance.

But existing pension wealth is certainly very unequally distributed. Despite a spate of government reports we still have no precise map of the distribution of pension entitlements but we do know that in the late 1990s the top 10 per cent of recipients obtained 51 per cent of all pension-related tax relief while the top 20 per cent receive 67 per cent of this relief (37). While the Pension Reserve Fund would channel resources to all pension funds catering to the mass of employees and small savers, those with funds above the upper limit would not qualify.

The regional pension boards could offer basic supplementary coverage to all but encourage employees to save more themselves by offering to match, say, the first £1,000 of annual contributions pound for pound, and a further £3,000 each year at 50p per pound. As with SERPS, extra contributions would mean extra entitlement. The matching approach to public subsidy would mean that lower paid workers could be given as big an incentive to save as higher salary earners, removing the regressive features of the present system of tax relief. The existing system of tax relief could also be reduced to a uniform allowance at the lower tax rate, so that richer pensioners lose some of the special tax relief they currently enjoy.

My main aim is to identify sources of pension provision and to leave scope for different ways of applying that revenue to pension needs. But I do urge that future pension provision should help to reverse existing extreme and growing inequalities. To this end I would propose that the Pension Reserve Fund would seek to ensure that:

- all "Citizens' Pensions" would be topped up until they were equivalent to at least a half of median income, adding a "Defined Benefit" element to the package
- there would be an income ceiling – at perhaps twice or three times median income – above which the individual would no longer qualify for top ups
- between these two limits there would be a progressive taper, giving the same absolute amount to everyone, for free, but allowing all to build up extra entitlement if they make contributions of their own.

8
Two objections

The asset-levy proposal is likely to encounter a range of theoretical and practical objections. Here are two that merit attention.

Is it the case that share titles acquired today cannot be used to furnish pensioners' income in the future since this will have to come from the output of future workers?

It is often claimed that future pensions must come out of future production, and that this will inevitably come out of what is available to future workers (38). The premise is correct but the conclusion does not follow, since it ignores the way in which shares and bonds establish a claim on future streams of income. With the shares they received from the levy the pension reserve funds would hold assets with a strong claim over future income streams, largely at the expense of those with large share-holdings. Diluting existing shares by about 1 per cent a year, the share levy would tend to re-distribute from the richest 5 per cent of the population to all the net beneficiaries of the new universal pension arrangements.

Those who make this objection really wish to insist that future pensions are best paid out of future taxes and that acquiring assets today adds nothing to future output. Since it will be difficult to meet future pension targets it is probably true that some future taxes will have to rise a bit – I've already suggested a 1 per cent increase in NIC contributions across the income range. But taxes of this sort are not the only way of securing future revenues. In the society in which we live those who own shares and bonds also receive future income streams in consequence. The share levy enabled the pension reserve fund to obtain some of this rentier income and devote it to paying decent pensions.

Would a share levy harm pension funds and small investors?

Another line of criticism would urge that the share levy will hurt those with a small stake in shareholdings, including pension funds themselves. Care would have to be taken that all pension funds gain more than they lose from the overall workings of the share levy. But this would not be difficult. Pension funds of all types accounted for 15.6 per cent of ownership of UK public companies at the end of 2002, with insurance funds, some relating to pension provision, holding a further 19 per cent (39). Assuming that all pension funds were in receipt of assets raised by the levy they would be very probably be receiving more than they lost by dilution. However there might be a case for compensating certain pension and insurance funds for any loss of value occasioned by the levy. This would speed up the redistributive process as well as counter a likely source of objection. The funds would simply receive compensation, equivalent to their holdings of shares, as well as their due contribution from the Pension Reserve Fund. The possibility of turbo-charging the levy system in this way might help to deter demagogic attempts to claim that the scheme would not help genuine pension funds.

The pension fund network should also reach out to the small investor, by helping to establish a wider framework of responsible governance – one less at the mercy of over-mighty chief executives and over-ingenious financial officers.

9
Governance principles

The regional pension boards could be encouraged to use the voting power of their shares in ways which promoted good corporate governance.

At present the commercial fund managers must bear some of the responsibility for the absurd share-price bubble of the late 1990s, for continuing poor governance and exaggerated executive compensation. The pension boards could also carry out their own research, something the commercial fund managers have too often left to self-interested investment banks and finance houses.

The network of pension boards, with their own staff and specialists, could push for less extravagant compensation for top executives and financial intermediaries. As knowledgeable and well-resourced transactors, they could help investors generally to acquire more leverage over business leaders and organisations, including the large banks. The funds would have an interest in curbing tax evasion, and, as shareholders, could act as the eyes and ears of the tax and regulatory authorities, just as institutional investors did when they exposed the abuses of Conrad Black's regime at Hollinger.

While receipts from corporation tax have been quite buoyant in recent years, it is also clear that many multi-national concerns use transfer pricing, "thin capitalisation" and the manipulation of allowances to bring down the effective corporate tax rate. The tax authorities do have ways of identifying these problems and, so far as corporation tax is concerned, there is a case for basing the tax on operational profits so that inter-company loans don't cloud the picture. The new pension fund network would have the resources to penetrated the mysteries of an increasingly "financialised" environment (40).

In recent years Socially Responsible Investment (SRI) has ceased to be a fringe enthusiasm and has become part of the mainstream – the major exchanges now each offer their own SRI indexes. The proposed new source of pension finance would mean that the pension network would be in receipt of a stream of shares that would be broadly representative of all companies in the land. Since pension boards would be barred from selling these shares they would not be able to boycott companies whose practices they disapproved of. However, they would be able to "engage" such companies by using their shareholder power at AGMs and in other consultations. This might allow them, if their members agreed, to discourage anti-social practices – say, the denial of rights to employees, or production processes destructive of the environment.

Pension funds are, by their nature, long term investors who have only a tiny portion of their assets in any one company. Their members will be exposed to the negative effects of socially irresponsible practices while benefiting little, or not at all, from them. If pension boards were responsive to the views of members they could well be concerned for the overall health of the economy and its ability to generate returns. But they would be under no compulsion to endorse profitable abuses that can generate short-term out-performance at the expense of the community – since those with pension rights would be the community.

Notwithstanding measures to ensure that all pension funds and small savers benefit from the levy, it is bound to be controversial, because it is re-distributive and because, over time, it will boost the influence of existing "activist" public sector pension funds. . In the Swedish case the fact that twenty families famously control the bulk of the country's major companies made them particularly apprehensive about loss of control. In the UK and US activist funds already have clout, and responsible managements are learning to live with a new type of institutional investor.

The existence of public, not-for-profit pension suppliers could help raise standards in the pensions industry. The government could also establish more transparency – and stiffer limits – on marketing spend and fees in the commercial sector. A string of scandals and failures – from the pension mis-selling of the 1980s and 1990s to Equitable Life and split-capital funds – show that the authorities have not been good at protecting the interests of savers. Where savings attract generous tax relief the authorities have an even greater duty to ensure that subsidies do not licence waste, greed and unnecessary risk. The Financial Services Authority should end the widespread practice whereby brokers offer "soft commission" – free business services – in return being awarded trading business. Paul Myners' report singled this out as a practice which makes it difficult, or even impossible, for trustees to properly identify and control trading and research expenses (41). UK financial costs now loom large enough to distort the national accounts. They can be brought down, using legislation, regulation and investor vigilance.

10
Can we plug the gap?

I started by insisting on a future pension funding gap of 3 per cent or more of GDP by 2031, a figure rising towards the 4 per cent shortfall identified by the Pension Commission for 2050. Could the approaches I have outlined fix the pension deficit?

The Pension Commission itself insists that there are a rigorously limited number of ways of solving the problem: either the retirement age must be raised, or pensioners allowed to fall behind, or taxes to be raised, or compulsory saving to be introduced. Wishing to avoid rising pensioner poverty the Commission seemed to lean towards some raising of the retirement age plus greater compulsion to save. In advance of the Commission's formal recommendations, due to be issued in Autumn 2005, its chairman has pointed to the undesirability of lowering pension levels, the difficulty of raising taxes and the injustice of raising the retirement age for manual workers (42). While the eventual package might include some benefit pruning the main effort, it is implied, must go into re-charging "voluntarism" and, if necessary, compulsory saving. Critics have urged that compulsory saving would feel very like higher taxes and that it would anyway be inappropriate and rigid for many on low or medium incomes who were struggling with personal debt or facing emergencies (43).

Neither the Commission nor its Chairman have yet addressed the TUC proposal that employers should be compelled to contribute to pension funds on behalf of all employees. I have outlined the reasons for believing that the best form of employers' contribution, where it is possible, would be the issuing of new shares by employers to a multi-employer Pension Reserve Fund, those shares to be held, not sold, to furnish future pensions. The Reserve Fund could bolster the holdings of the newly established Pension Protection Fund and could also help to establish a regional network of pension funds. The new layer of coverage supplied to all by the network could also encourage personal saving by offering to match contributions up to some annual threshold.

By itself the share contribution scheme I have outlined would be helpful but not a "magic bullet". There is no magic bullet. But every little helps. The UK corporation tax, levied at 30 per cent is likely to raise about £35 billion in 2005-6, a level already reached in 2000-1. If the share levy was set at 10 per cent of profits, it would, after allowing for rebates, raise £10 billion annually. If all shares issued to the pension reserves were held to 2031, with re-investment of earnings, then a fund of £700 billion could be built by that date. I assume here that profits grow in line with GDP at 2.5 per cent a year, and that the fund will achieve 5 per cent annual growth. If contributions raised by the matching funds device yielded a further £300 billion, then the total fund would be worth £1 trillion by 2031. If the fund then adopted a pay-out rate of 4 per cent of its total value it would be able to pay out £40 billion annually, equivalent to 2 per cent of GDP, which would have roughly doubled by that time (44).

This would be a major help in closing the 3 per cent funding gap but where does the rest of the target 14 per cent of GDP come from?

Public pensions are already planned to supply 6 per cent of GDP but I have urged that a strengthened Basic State Pension should be paid to all, regardless of contribution record. This would be paid for by raising national insurance contributions across the range by 1 per cent of income. The improved Basic Pension would supply an extra 0.8 per cent of GDP. Ending the present system of tax relief on pension plans could raise 1 per cent of GDP, which could be used to strengthen the Second State Pension and restore SERPS. Private pensions could supply about 4 per cent of GDP; notwithstanding the closure of many schemes this proportion could be maintained with cost reduction in the financial sector, better funding of the Pension Protection Fund and the availability of more suitable assets, such as long-dated, inflation-proofed bonds. A well-managed economy, combined with the eradication of age discrimination, could raise the number of the over-65s who find work, without resort to the regressive expedient of a higher state pension age. About 8 per cent of those over the state pension age work today and this proportion could be raised to 12 or 15 per cent. The remuneration of the older worker could add a further 1.2 per cent of GDP to meet the income needs of those over 65.

Add these all together with the 2 per cent from the Reserve Funds and we have a total of 14 per cent of GDP, which is what will be needed if we are to ensure that pensioners do not fall behind the rise in national wealth. Moreover if we consider income distribution within the pensioner population, and the distribution of wealth itself within the wider population, the changes will have a progressive character.

The reader will appreciate that we have really only scraped home here since there are several downside risks. Will the efficiency savings materialise? Won't there be other demands on National Insurance income? And so forth. It is for this reason that the 2 per cent coming from the share levy is playing a vital role. The way the levy is raised combined with the uses to which it is eventually put will also be a strong force for greater economic equality as well as, hopefully, for more responsible fund management.

I concede that the measures I propose have a sweeping and radical character. But I doubt that anything much less will suffice to tackle the simultaneous crisis of public and private pension provision we now face. In my view robust proposals for reform should help us to pay decent pensions not furnish excuses for removing pension rights to which many have contributed all their lives.

Notes

1 The Pension Commission, (2004) Pensions: Challenges and Choice: the First Report of the Pension Commission, London, TSO, pp15, 148. According to the less optimist projections the shortfall could be 6 per cent or more of GDP.

2 Government Actuary's Department, (2003) Press Release 18 December.

3 The argument that generational justice requires us to strive to maintain the ratio of per capita pension income to average income is made by John Myles in 'A New Contract for the Elderly', in Gosta Esping-Andersen et al (eds), (2002) Why We Need a New Welfare State, Oxford University Press, Oxford. In an article sent to press prior to publication of the Pension Commission report I estimated that pensioners would already need to receive 16.8 per cent of GDP in 2031 if they were not to fall behind. See Robin Blackburn, R, (2004) 'How to Rescue a Failing Pension System', New Political Economy, December. Since the ageing effect rises more gently after 2031 my estimate was broadly compatible with that outlined in the Commission.

4 Secretary of State for Social Security, (1998) A New Contract for Welfare: Partnership in Pensions, Cm 417, London, TSO, p103.

5 Select Committee on Economic Affairs, (2004) House of Lords, Aspects of the Economics of an Ageing Population, Volume II, Evidence, Memorandum by PricewaterhouseCoopers, TSO, p77.

6 It is worth bearing in mind that all "property income" generated by corporations in 2002 amounted to £122 billion or a little over 12 per cent of GDP. Monthly Digest of Statistics, January 2004, p9.

7 Department of Work and Pensions, (2003) Work and Pension Statistics, p86. The top fifth of pensioner couples received median income of £510 a week, or £255 each, while single pensioners received £261 a week. There are much greater inequalities within this top quintile than in the others.

8 Arber, S, and Ginn, J, (2004) 'Ageing and Gender', Social Trends, No 34, January, p9.

9 Ibid, p10.

10 Ibid, p10.

11 Pickering, A, (2002) A Simpler Way to Better Pensions: an Independent Report, London, TSO, p70. For figures drawn from an Amicus survey that found slightly worse coverage see Simpson, D, (2004) 'The Pension Thieves', The Guardian, 11 March. The weakness of provision was acknowledged in the DWP Green Paper, (2002) Simplicity, Security and Choice: Working and Saving for Retirement, Cmd 5677, TSO, pp29, 51, but the main remedy, apart from some welcome simplifications, was still to urge people to save more within the framework set out in the earlier Partnership for Pensions. Despite yeoman service from the experts commissioned to supplement information contained in the

Green Papers and DWP publications, the government has not invested serious resources in clarifying the deficit in pension wealth held by the population as a whole. Myners, Sadler and Pickering were expected to produce recommendations relying on their own expertise and with a negligible research budget. In an appendix to its report the Pension Commission complains about the severe defects in official information.

12 Financial Times, (2004) 'Pension Crisis Comes to the Boil', Editorial, 26 July.

13 Blackburn, R, (2003) 'The Great Pension Crunch', The Nation, 16 February.

14 Hall, B, (2005) 'Pension aid plan raises viability fears', Financial Times, 23 February.

15 Hilton, A, (2004) 'Pension Sums Don't Add up', Evening Standard, 20 February. See also Coggan, P, (2004) 'Safety Net Still Has Holes In It', Financial Times, 23 February.

16 DWP, (2002) Simplicity, Security and Choice, p40.

17 Hughes, G, and Sinfield, A, (2004) 'Financing Pensions by Stealth', in Hughes, G, and Stewart, J, (eds) Reforming Pensions in Europe, Cheltenham, pp163- 191, p182.

18 I survey this research in chapter 2 of Blackburn, R, (2002) Banking on Death, or, Investing in Life: The History and Future of Pensions, London, Verso.

19 The Pension Commission report does not give a figure for such charges as a percent of GDP but it does confirm that explicit and implicit charges can easily lead to a reduction in yield of 30 per cent. See Pensions: Challenges and Choices, pp218-226.

20 Crooks, E, and Timmins, N, (2004) 'Official View of Size of Economy in Doubt, Financial Times, 31 January – 1February; Timmins, N, (2004) 'ONS Revises Figure Donated to Pensions Pot', Financial Times, 1 July.

21 The DWP, basing itself on Eurostat, told the House of Lords enquiry that overall (state plus private) pension expenditure in the UK was 11.5 per cent of GDP in 1999 while public provision was 5 per cent of GDP. However it warned that one could not necessarily impute a private expenditure share because the figures are from different sources. House of Lords Select Committee on Economic Affairs, (2004) Aspects of the Economics of an Ageing Population, II, Evidence, p23.

22 Bogle, JC, (2003) 'Not-So-Mutual Funds', Wall Street Journal, 14 November.

23 I explore these issues and the double accountability deficit of what I call "grey capitalism" in Banking on Death, especially chapters 2 and 3.

24 See the CBI report Securing Our Future: Developing Sustainable Pension Provision in the UK, July 2004.

25 UN Population Division, (2001) Replacement Migration: Is It a Solution to Declining and Ageing Populations?, United Nations, New York, pp71-6.

26 For other improvements to the State Pension see Davies, B, Land, H, Lynes, T, MacIntyre, K, and Townsend, P, (2003) *Better Pensions: the State's Responsibility,* Catalyst, London. While concurring with the point made by the title of this pamphlet, I will be exploring further ways in which private employers can be obliged to contribute to public provision of better pensions.

27 Boltho, A, (2003) 'What's Wrong with Europe?', New Left Review, No. 22, July-August; Blackburn, R, (2002) 'Eurodenial', New Left Review, No. 18, November-December.

28 TUC, (2002) Prospects for Pensions, May, pp20-9.

29 For details of this campaign see the TUC website.

30 See Pontusson, J, (1994) 'Sweden', in Anderson, P, and Camiller, P, (eds) Mapping the West European Left, Verso, London. In Britain capital levies to meet social needs have been canvassed by such eminent thinkers as Sidney Webb, J.M.Keynes, and James Meade, as Martin Daunton explains in Daunton, M, (2002) Just Taxes; the Politics of Taxation in Britain, 1914-1979, Cambridge University Press, Cambridge, pp71-2, 187-9. In the 1950s Richard Titmuss and Richard Crossman for a time won the Labour Party over to the idea of meeting secondary pension provision by means of a publicly-controlled, share-holding, social fund – see Titmuss, R, and Crossman, R, (1957) National Superannuation: Labour's Policy for Security in Old Age, London. See also Titmuss, R, (1960) The Irresponsible Society, Fabian Society, 1960. I have more on this in Banking on Death, chapter 5 and the Conclusion.

31 Public companies might be required to issue "convertible bonds" rather than simple shares – these are bonds which convert to shares above a certain price. An instrument similar to these "convertibles" could allow the pension fund to gain from any large rise in overall share earnings but would set a bond-like basic return.

32 Malkani, G, (2004) 'City Shares Scheme to Aid Failing Schools', *Financial Times*, 29 June. I believe this funding method would be far more appropriate for pension provision than for the purpose under consideration in this report, which was to facilitate corporate contributions to the government's plan for City Academies.

33 By this I mean that a national pension Reserve Fund would allocate resources to regional pension boards which would manage these funds. Allocations would reflect the size and characteristics of each region's population.

34 Of course companies can always raise money from banks or the stock market. But since they don't exist in a frictionless world, they prefer to finance investment out of their own revenues if possible and the obligation to reduce a pension fund deficit detracts from available revenue. In recessions the need to stump up cash for the pension fund has led to job-shedding as well as slashed investment.

35 The workings of path dependence in this area are explored by Hacker, JS, (2002) The Divided Welfare State: the battle over public and private benefits in the United States, Cambridge, Cambridge University Press.

36 Timmins, N, (2004) 'CBI calls for change in proposed pension savings restriction', Financial Times, 10 March.

37 Hughes, G, (2004) 'Financing Pensions by Stealth', in Hughes, G, and Stewart, J, Reforming Pensions in Europe, Cheltenham, pp163- 191, p182.

38 In an otherwise acute discussion of pension finance Nicholas Barr makes the point about future production but omits non-pensioner asset-holders' claims on future income. See Barr, N, (2002) The Welfare State as Piggy Bank, Oxford University Press, Oxford, p149-56.

39 Office of National Statistics release, July 2003. Following the collapse of the share bubble in 2000 pension funds reduced their holdings of shares. According to this release UK individuals, banks and other financial institutions owned 27 per cent of publicly quoted shares while "foreign" owners accounted for 32 per cent; however British subjects could well be the beneficial owners of many of these "foreign"-held shares by dint of using overseas tax havens. Insurance companies owned 19 per cent of public shares – a portion of these holdings, perhaps a third, could relate to provision for retirement and might qualify for a rebate.

40 Devereux, MP, Griffith, R, and Klemm, A, (2004) Why Has the UK Corporation Tax Raised So Much Revenue?, Institute of Fiscal Studies, May. However John Plender and Michael Simons published an expose of widespread tax avoidance by finance houses and some other concerns in the Financial Time, 21 and 22 July, 2004.

41 H.M. Treasury (Paul Myners), (2001) Institutional Investment in the UK, a review, TSO, March 2001, pp95-6.

42 Timmins, N, (2005) 'Commission to Reject Flat Rate Model', Financial Times, 11 May; Winnett, R, (2005) 'Labour's Pensions Guru Wants to Force Us to Save', Sunday Times, 22 May.

43 Churchill, N, and Mitchell, M, (2005) Labour's Pension Challenge: Building a progressive settlement, London, Catalyst.

44 UK GDP growth was 2.6 per cent a year between 1990 and 2003. While I believe that the new regime will enhance the ability of the tax authority to discover profit I have made no allowance for this. The year 2031 is an appropriate benchmark because the ageing effect will by then have reached a new level. I have a similar computation for the US in 'The Pension Crisis and How to Tackle It', Challenge, the economics magazine, September-October 2004.

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