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History and Policy memorandum submitted to the Work and Pensions Committee

Pension Reform

Summary

1. To understand the present and future position of pensioners we need to know some history. It takes 40 years to accrue a pension. There are pensioners today with rights dating back to legislation passed in 1925. Everyone's pension rights are an incomprehensible mish-mash deriving from constant short-term policy changes over the past 80 years.

2. The last major review of British pensions, the Beveridge Report (1942), established fundamental principles:
   Subsistence level benefits
   Rational, uniform administration
   Universal compulsory cover and uniform state pension rights.

3. In combination, Beveridge intended that these principles would:
   Remove the need for means testing and pensioner destitution arising from their reluctance to apply for means-tested benefits
   Reduce administrative complexity and cost, not least by excluding the private sector
   Maximise transparency
   Create incentives to save
   Minimise consumer risk by giving the same pension for the same contribution
   Protect women and others unable to sustain long-term contributions

4. Contrary to a belief perpetuated by the Work and Pensions Secretary[1], the Attlee government largely ignored the central principles of the Beveridge Report, causing many of the current problems with the pensions system.

5. The Turner Commission returned to many of Beveridge's basic principles:
   Universality, basing state pension rights on citizenship

[1] John Hutton speech to Fabian Women's Network, 18 May 2006: "Following the blueprint Lord Turner recommended, this Labour government will set in motion the biggest renewal of our pension system since Clement Attlee's post war Labour Government implemented the Beveridge reforms."

An independent authority to oversee pensions in the collective interest
Unification of funded pension contributions (under the NPSS)
Phasing-out means-tested benefits

6. In the White Paper, the government has abandoned most of these, retaining many of the weaknesses in the present system, including:
Continuing poor levels of pension in Britain, not least for women
A lower state pension at 68 for claimants than would be the case today
Means tested benefits for one-third of future pensioners
Enhanced levels of individual consumer risk
Administrative complexity, and elevated costs
No independent governing body or cross-party consensus

7. The White Paper meets the government's affordability test: the provisional commitment to restore the earnings link makes official priorities clear. But, it fails tests of simplicity, transparency, political viability and social justice. Under its proposals, British state pensions will remain among the worst in the western world.

Historical Perspectives: the Beveridge Report and its current relevance

8. The 1942 Beveridge Report [*Social Insurance and Allied Services*] sought to impose administrative rationality and reduced costs on the ramshackle apparatus of state social security schemes that had developed over the preceding thirty years.

9. But the postwar settlement departed from the Beveridge Report in a number of important respects. Under the post-war Attlee government and its successors, constant political amendment coupled with the inclusion of the private sector created inadequate basic state pensions and a regulatory mess impenetrable to anyone outside a small body of experts.

10. Beveridge demonstrated that:

    a. Means tested supplements (under the Assistance Board) to vast numbers of state pensioners were expensive to administer and created inequalities between those who claimed and those who did not.

    b. Poly-centric systems of privatised social security administration, like those found in the National Health Insurance Scheme (the forerunner of the NHS), were administratively more costly and less efficient than centralised unified systems. The running costs of NHI were nearly nine times those of the unified Unemployment Insurance scheme. Commercial competition between multiple providers created what Beveridge called 'duplication and waste'.

    c. Fluctuations in income security rendered regular saving impossible for poorer people, leading to high drop-out rates among those contributing to voluntary life insurance policies, but creating large profits for commercial insurance companies who sold policies on the doorstep to clients who could not afford them. Beveridge wanted to keep commercial insurance away from the administration of state benefits.

d. Unification minimised risk and guaranteed social justice as all scheme members were guaranteed the same benefits for the same contribution. Then as now, this did not happen under commercial systems.

11. In his 1942 White Paper, Beveridge set out to establish fundamental principles of social justice:

    a. Subsistence level benefits to:

        i. Remove means testing, and reduce administrative complexity and cost

        ii. Create incentives to save for a better pension, either through non-profit making institutions (such as Friendly Societies) or the commercial sector.

        iii. Avoid pensioner destitution caused by the widespread reluctance to apply for means-tested supplements.

    b. Rational, uniform administration designed to:

        i. Forbid 'contracting out', which increased administrative costs.

        ii. Exclude the commercial sector from the administration of public benefits because of higher administrative costs.

        iii. Minimise consumer risk derived from:

            ○ Markets: because national pooling would avoid different benefits being paid for the same contribution

            ○ Politics: unified administration would promote rationality and discourage political 'tinkering' for short-term gains.

        iv. Sustain transparency, prevent complexity and avoid anomalies

    c. Universal compulsory cover to:

        i. Protect women and others unable to sustain contributions

        ii. Prevent complications (and costs) due to problems of persistence.

Historical Perspectives: After Beveridge

12. Beveridge assumed that unity, universality and uniformity would guarantee social justice, transparency and public support for his scheme that would protect it against future amendment or other political meddling. He was wrong.

13. Attlee's postwar Labour government introduced a flat-rate state pension as part of the newly established welfare state. However, owing to strong Treasury opposition,

pension payments were never at subsistence level. From the start, means-testing was needed for those with no other income in old age.

14. Since the 1946 National Insurance Act we have seen a succession of major pension reforms and innumerable minor changes. None of these alterations has restored Beveridge. Many have broken with his principles.

15. Almost all these major changes were shaped by the Treasury (e.g. the introduction of a minimalist earnings-related pension in 1961, private pension plans in 1988, stakeholder pensions in 2000 and a state second pension in 2002). Those that were not (such as the introduction of SERPS in 1978) it bitterly opposed.

16. Postwar pensions policy has been dominated by the Treasury, excluding stakeholders such as trade unions from the policy making process.

A New Pensions Settlement for the Twenty-first Century?

17. In its review of current pensions, the Turner Commission returned to many of the principles established by Beveridge. Turner sought to:

    a. Eliminate pensioner poverty by:

        i. Raising pension benefits

        ii. Moving to a single flat-rate benefit to reduce complexity

        iii. Instituting a residency rather than contribution qualification, and

        iv. Indexing future rises to average earnings

    b. Minimise means-testing and thus enhance incentives to save and minimise pensioner poverty arising from non-claimed benefits

    c. Ensure financial viability by raising the state pension age

    d. Provide universal earnings-related top-up benefits via a new funded National Pensions Savings Scheme with auto-enrolment. The NPSS would be administered by a body responsible to Parliament rather than government, and oversee investment of contributions in stock and bond markets.

18. The government, in the White Paper, has chosen to break with many of Turner's recommendations. For example

    a. The basic state pension (BSP) will continue to be based on contributions rather than residency. Various proposals for mitigating the effects of this are proposed (e.g. reducing the number of qualifying contribution years to 30), but would not be backdated. The existing problem of large numbers of people, mainly women, with poor contribution records and little or no pension entitlement will continue.

b. Although government intends to re-index the BSP to earnings this will happen in 2012, not 2010 as Turner recommended. This delay generates exchequer savings over the long term. But the price is a larger number of people condemned to means-tested assistance and a large number condemned to poverty because they will fail to claim that assistance.

c. By 2050 we are promised that only about one-third of pensioners will still be claiming Pension Credit. But as just over 40 per cent of pensioners are eligible for Pension Credit today, this hardly represents a radical improvement.

d. Although the White Paper is vague when it comes to discussion of earnings-related pensions, it is fairly clear that the government envisages a private sector solution. This will be no surprise to anyone who has studied the history of state earnings-related pensions in Britain, not least because the City, the pensions industry, the Treasury, and occupational pension scheme members fought a successful battle against similar proposals made by Labour in 1957. If administration of NPSS is placed with the private sector we are offered a rehashed version of Stakeholder pensions, with increased compulsion and retaining full exposure of the contributor to the risks of provider or market failure.

19. The White Paper promises a state pension rising to £135 per week[2] as the retirement age rises to 68. This is no improvement for the average pensioner: the contrary is the case.

a. £135 is less than the state pension that contributors can receive today at 68. E.g., a man retiring in 2006 with full contributions under SERPS and S2P, with earnings rising from £3,500 to £18,500 (1978-2005) could defer his claim to his state pension until 68 and receive £199.85 per week. A woman claimant with the same earnings profile could receive more (£279.05 per week - but this advantage will disappear by 2020 as male and female retirement ages are aligned[3]). From 2020 to 2044 (should deferment regulations continue) this £199.85 per week would fall as the pension age rises. Future pension rights will depend on birth date (and gender): for the same contribution, the state pays different pensions to different generations.

b. The White Paper proposes to abolish contracting out for all DC schemes (personal pension plans, Stakeholder and reformed company pension schemes).

i. Only DB schemes are to remain exempt: as the White Paper itself remarks, numbers covered by DB pensions have declined recently[4]. A large proportion of the future working population will fall within the combined state pension, which will become flat-rate by 2030.

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[2] For forty years contributions / credits. This section works (as does the WP) in today's prices.

[3] This paragraph combines information from The Pension Service, *Guide to State Pensions*, April 2006, p.39; The Pension Service, *How to get extra weekly State Pension or a lump sum payment: your introduction to State Pension deferral*, April 2006; The Pension Service, *Your Guide to State Pension Deferral*, April 2006, p.29. All are available at www.thepensionservice.gov.uk

[4] There were 2 million fewer members of open private sector occupational pension schemes in 2004 than in 2000. White Paper on Pensions, Executive Summary, p.10, para. 21

ii. The White Paper states that forty years of work or credits under its proposed system, will give a low earner an additional top-up of around £60 per week[5]. Added to the present day £84.25 BSP, this makes £144.25 at age 65. Deferred for three years, this offers £189.26 at 68.

iii. This leads us to conclude that the state pensions on offer in the White Paper are unfair, uneven and offer a disguised pension cut to future pensioners.

20. The White Paper accuses other industrialised countries, also faced with pension problems, of demonstrating 'the dangers of establishing unsustainable policies, requiring them to reduce commitments.' Other western countries have been forced to modify and reform their pension system in the face of growing longevity, falling birth rates and budgetary difficulties. However, their future pensions still compare very favourably with the proposed British reforms, for example:

    a. In Germany, by 2030, current pension reforms will reduce the earnings-related state pension from c. 70% to around 58% of previous average earnings.

    b. In France, the 2003 reform offers a full pension (at c. 70% of previous earnings) for all completing 42 years contributions / credits. 5% is deducted for each year short of this requirement. This means that 40 years contribution/credit will still create the right to a pension at 60% of average previous earnings.

    c. In the USA, social security currently offers a pension at c. 40% of previous earnings for a 40-year working life.

    d. In Britain, the White Paper proposes a pension of c. 30% of median earnings for 40 years of contributions / credits by 2044.[6] By any estimation, this is meager.

21. In Sweden and Italy, real and complete pension reform has been achieved. The Notional Defined Contribution systems adapted by both these countries calculate pension as a proportion of previous earnings, modified by age-cohort size and life expectancy on retirement. This creates a political compact between generations while avoiding the penalties and risks imposed by market uncertainties under real DC schemes. It also enables people to plan for their retirement more effectively. If the British government places the administration of NPSS in private hands, this will impose the very uncertainties and risks on contributors that these countries have sought to mediate.

22. All pension schemes in these countries have historically been administered under systems of joint representation from both sides of industry. This establishes the link between contributors and scheme governance that has long facilitated public deliberation about pensions and the possibilities for their reform. In Britain, by

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[5] White Paper, ch. 3, p. 119, para. 3.52

[6] See White Paper, ch. 3: point 3.15, p. 108. The 'simpler entitlement conditions' of 30 year contributions / credits offers an entitlement to 'about 20 per cent of median earnings' and will evidently require means-tested supplementation.

contrast, policy remains in the hands of a small group of economic specialists in the Treasury, and financial viability is always given absolute precedence over transparency and social justice. This perpetuates mistrust in government as a guarantor of social well–being.

Conclusions

23. By obscuring important differences between the 1942 Beveridge Report and the 1946 National Insurance Act ministers have claimed that their White Paper is 'a new Beveridge'. It is not.

24. Ministers have contrived to give the impression that the White Paper represents 'a new pensions settlement for the twenty-first century' because it embodies the key principles of the Turner Report. It does not.

25. The White Paper is merely the latest instalment in a long series of changes to British pensions that have attempted to mitigate the worst effects of the postwar settlement but almost always made it worse.

26. The White Paper claims to offer working people a better state pension on retirement in the future. It does not.

27. Ideally we would like the government to:

    a. Restore the right to a basic state pension that does not require means-tested supplements and extend this to all UK citizens and long-term residents (as recommended by the Pensions Commission and as currently offered in the Netherlands and Sweden).

    b. Retain a centralised NPSS and establishing an independent, representative governing body to administer the earnings-related pensions it offers (as recommended by the Pensions Commission).

    c. Abolish contracting out for DB schemes, leaving employers to adjust occupational pensions accordingly.

Notes:

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We are the editors of *Britain's Pensions Crisis: History and Policy* (to be published by Oxford University Press in association with the British Academy in September 2006) and this memorandum draws on that work.

History and Policy was founded by a group of professional historians at London and Cambridge Universities, and now involves a network of historians around the UK. They believe that today's 'evidence-based' policy environment is hampered by a lack of historical input and a reluctance to involve historians. This can result in flawed decisions based on inaccurate historical assumptions.

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