Maintaining consensus on pension reform?

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Fiscal and economic pressures contribute to a challenging environment for pension reform

UK pension policy has been bedevilled by a lack of continuity over an extended period. Major reforms legislated for in the last Parliament did secure a significant level of consensus. However, the economic downturn which followed led to questions about how and when parts of the package can be implemented. Such details matter because the reforms were designed as a coherent and integrated whole.

PENSIONS COMMISSION RECOMMENDATIONS

The reforms arose from the work of the Pensions Commission (2002 - 2006) which found that, faced with an increasing proportion of the population aged over 65 and pensioners living longer in retirement, individuals and society had four options:

1. Pensioners would become poorer relative to the rest of society
2. Public spending on pensions would need to rise
3. People would need to save more
4. People would have to work longer

The Commission recommended a package of reforms to the state and private pension systems. Many of these were adopted by the Labour Government, with some modifications. These included:

- Reforms to the state pension system to make it less means-tested and more universal than if existing arrangements continued; in particular, the link between increases in the basic State Pension and average earnings would be restored, probably in 2012. To help pay for this, the state pension age would rise from 65 to 66 over two years from 2024; to 67 over two years from 2034; and to 68 over two years from 2044. The pension age for women was already due to rise from 60 to 65 between April 2010 and 2020.
- Reforms to the private pension system would provide access to workplace pension saving for those low to moderate earners currently not saving enough for their retirement. Employers would have new duties to automatically enrol employees into a pension scheme and, unless the employee opted out, make minimum contributions of three per cent of earnings.

Low to moderate earners have not been saving enough for retirement

- To enable this pension saving, a new national low-cost, workplace pension saving scheme (now called the National Employment and Savings Trust (NEST)) would be established. The Commission argued this was needed because existing provision did not meet the needs of lower earners, in particular because of the high charges associated with it.

IMPLEMENTING REFORM

The principle of the reforms attracted broad support. However, most of the measures remain to be implemented and fiscal and economic pressures in recent times have led to questions about when and how this should happen.

For instance, with a view to protecting small employers in difficult economic circumstances, the Labour Government reviewed the timetable for rolling out the new duties to be placed on employers. Although they would still start in 2012, they would be phased in more slowly than originally intended, with the aim of full implementation by 2017. The Conservatives expressed concern that such a slow start could leave individuals with a gap in contributions they might never make up. In addition, they were concerned that the introduction of NEST might cause employers to 'level down' existing occupational pension provision by, for example, reducing the amount they contribute. They therefore said they would review the "NEST" project.

All three major parties agreed the earnings link should be restored in this Parliament, but differed about the exact date from which this could be afforded.

CHALLENGES FOR THE FUTURE

These reforms were designed as a coherent and integrated whole, with the different parts dependent on each other for their success. For example, automatic enrolment is a way of strongly encouraging pension saving. Much of the support for this policy was contingent on the fact that people would be better off as a result than on means-tested benefits. The minimum employer contribution, the state pension increases and low charges for pension saving were all designed to ensure it would 'pay to save' for those on lower incomes. There is a risk that delaying the introduction of any of these measures could reduce the returns from saving for some of the target group. If a perception grew that people might not gain from saving, this could reduce participation levels. Confidence could also be undermined if people felt pension policy was subject to continual reform.

The new Government has announced that the earnings link will be restored from 2011, with a "triple guarantee": pensions will rise by the higher of earnings, prices or 2.5%. This helps keep the reforms on track. However, to pay for it, a review is to look at bringing forward the increase in the state pension age to 66, though not sooner than 2016 for men and 2020 for women.

In addition to this, there are ongoing concerns about declining pension provision in the private sector more broadly, particularly when compared to the public sector. Those employers who do provide pensions are tending to close final salary schemes, replacing them with less generous money purchase schemes (with benefits based on contributions made, investment performance and annuity rates). In contrast, most public sector employees are covered by schemes which provide more certainty for the future (with benefits based on final salary and length of service). A new independent commission is to review the long term affordability of public sector pensions, while protecting accrued rights. Reaching consensus on this, and on ways to support and encourage adequate pension provision in the private sector, will be major challenges for the future.