NATIONAL PENSIONERS CONVENTION

Achieving dignity and security in retirement

A report from the
National Pensioners Convention
Pensions & Income Working Party
November 2012

Introduction

This report is the result of over two years' worth of discussion, research and analysis undertaken by the NPC's Pensions and Income Working Party (PIWP) into various aspects of pensions and income policy. Over that time its members have included Elizabeth Audars, Mary Campbell, June Clarkson, Frank Cooper, Bryn Davies, Douglas Dean, Neil Duncan-Jordan, Dr Jay Ginn, Tony Lynes, Bob Pinkerton, Janet Shapiro and Brian Sturtevant as the chair. The NPC expresses its thanks and gratitude to all of them for the work they have undertaken.

The working party's work programme, which was endorsed by the Executive Committee and forms the basis of this report, was agreed follows:

(i) To consider an adequate level for the basic state pension and assess the level of income pensioners would need to maintain a modest lifestyle
(ii) To look at the effect of taxation on pensioners' incomes
(iii) To evaluate the relationship between an increased state pension and entitlement to benefits
(iv) To recommend how an improved state pension could be financed
(v) To assess the health of the National Insurance Fund
(vi) To investigate current issues affecting both existing and future state (basic and additional) and private (personal and occupational) pension schemes
(vii) To look at the impact of the Pension Act 2007 on existing and future pensioners
(viii) To consider how to counter inaccurate government statements on pension related data
(ix) To compare the UK state pension to others in Europe

All of these items are addressed in the report except item vii which refers to the Pension Act 2007. Whilst some work was carried out into the impact of the Act on existing and future pensioners it was felt that the pensions' landscape had moved on since that time and much of the discussion had now been overtaken by more recent events. For example, in the course of its work, the working party has also considered a number of additional items that are included here, such as the proposal for a single-tier state pension and the launch of auto-enrolment into workplace pension schemes.

The policies and recommendations set out in this report therefore show how government should introduce and fund a package of reforms, without laying out a specific timescale, but recognising the urgency of addressing the increasing economic pressures that older people face both now and in the future.

Summary

- There is an urgent need to strengthen the existing state pension by moving towards a Citizen's Pension funded through National Insurance, but based on residency of say 30 years, rather than contributions as the most effective way of tackling pensioner poverty, both now and in the future. Increasing the basic state pension for all existing pensioners to the official poverty level (estimated as £178 a week in 2012) continues to be the most effective way of covering the day-to-day needs of older people.
- This would largely remove the need for means-tested support for all but a very small number of individuals unable to meet the citizenship criteria and the main gainers would

be those, particularly women, who do not currently have a full contribution record. Our report shows that even those that are currently in receipt of means-tested support, would not be financially disadvantaged by raising the state pension above the official poverty level (providing housing and council tax benefit remained available).

- The basic and second state pensions should be uprated annually in line with average earnings, RPI (Retail Price Index), CPI (Consumer Price Index) or 2.5% (whichever is the greater) so that its value is maintained for the future and pensioners share in the rising prosperity of the nation.
- The State Second Pension (S2P) should be retained as a good earnings-related pension for all workers, maintaining the higher replacement rate for the low paid. This would be paid to everyone with a minimum of 7 years and a maximum of 50 years' contributions or credits.
- The state pension age (SPA) for men and women should be maintained at 65 from 2020 without any automatic linking of SPA to life expectancy.
- There are a range of measures that can be used to raise the necessary funds required to improve the state pension system, including abolishing the upper earnings limit on contributions, using part of the surplus (accrued and annual) in the National Insurance fund, reforming tax relief on private pension contributions and tightening up on tax avoidance and evasion.
- The detail of the government's proposed single-tier state pension is still awaited and will require further examination. However, in principle, whilst the single-tier pension will not apply to existing pensioners, those older people with incomes below £140 a week should be included in the new arrangements. Likewise, those currently below SPA should not find themselves less well-off under the proposed scheme when they retire than they would otherwise have been under the existing pension system.
- Over time the age related personal tax allowances could be harmonised by continuing to uprate them in line with inflation, whilst the under 65 allowance would rise by more than inflation. In due course the two would eventually equalise and those older people affected would continue to get an increase in their allowance.
- Placing the provision of a decent income in retirement for future generations of pensioners in the hands of either employers or the financial markets is an expensive folly. If it is desirable to encourage additional second tier pension saving with voluntary contributions from employees and employers, this could be operated through an auto-enrolled Voluntary Earnings-related State Pension Scheme (VESPA) with credits for caring as in NI.

Background

Successive governments have tinkered with our pension system – reluctant to grasp the need for substantial reform of the state pension, whilst being overly optimistic as to the ability of private occupational pensions to deliver prosperity for all. In fact the reliance on a combination of means-tested support for existing pensioners and decent occupational pensions for future generations is now seen as simply unsustainable.

What lies at the heart of the UK governments' approach to pensions is a simple contradiction. Even the latest documentation coming out of Whitehall states that "sufficient income in retirement is fundamental for people in their later years." But the pension strategy adopted over the last few decades, which started with the withdrawal of the state pension link to average earnings in 1980, has not only failed to tackle existing pensioner poverty – but in some respects will also end up making it worse for future generations of pensioners as well. The decline of defined benefit occupational pension schemes, changes to pension indexation, planned increases in the state pension age and the general effect of the government's austerity programme now means that the pensioners of tomorrow face an almost unprecedented attack on the quality of their retirement. As a result, it is essential that the arguments for an improved state pension system are understood and supported across the generations.

Adequate level of the basic state pension

The basic state pension remains amongst the lowest and least adequate in Europe, supplemented by a means-tested benefit Pension Credit, that despite all recent efforts, fails to reach around a third of those who are entitled to make a claim[1]. The latest figures show that in 2008/09 between £1.6bn and £2.9bn went unclaimed, with pensioners on average missing out on around £34 a week[2]. The fact that just under half of all pensioners (5m) are eligible for means-tested support to supplement their state pension proves that it is currently inadequate. In fact, Government Actuary's Department estimates show that if previous policies were to continue, the basic state pension as a proportion of average earnings - which in 1980 was around 23.5% - is likely to fall from around 14% today to just 6% by 2050[3].

As a result, the number of older people considered to be living below the officially recognised poverty line of 60% median population income (estimated at £178 a week before housing costs in 2011) is a staggering 2.5m[4] or nearly one in four. At least 15% of pensioners – over 1.5m older people – are living in persistent poverty (defined as living below 60% median population income for three out of the last four years) and around 61% of pensioner couples have an annual income of £15,000 or less, and 45% of all single pensioners have an annual income of £10,000 or less[5].

The present UK pension system has also failed to address inequalities in retirement income. At least three quarters of existing women pensioners do not qualify for a full basic state pension in their own right, because they lack the required number of National Insurance contributions or credits. Recent figures show that on average women tend to get around £40 a week less basic state pension than men[6] and those who have to rely on their husband's contributions receive just 60% of a full basic state pension. Persistent poverty is also concentrated among older women, with the proportion experiencing such poverty being three times that of the population as a whole[7]. Whilst many pensioners in poverty are therefore older women, even women retiring today can expect to have a pension income of just 68% of their male counterparts[8].

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[1] A state pension for the 21st century, DWP, April 2011
[2] Income related benefits: Estimates of take-up in 2008/09, DWP, 2010
[3] GAD Report 2007
[4] Households Below Average Income 2007/08, DWP, 2009
[5] Family Resource Survey, DWP, 2006/7
[6] Gross State Pension Entitlement, DWP, 2011
[7] Households Below Average Income, DWP, 2006/7
[8] Class of 2012, Prudential, June 2012

In a similar way, black and minority ethnic pensioners also experience a greater risk of poverty. For example, 39% of Pakistani and Bangladeshi, 33% of Indian and 29% of Black Caribbean elders live in households with incomes below 60% of the median population income[9]. These pensioners are more likely to have experienced unemployment during their working lives, limiting their chances to save and were disproportionately found in low-paid jobs, with very limited access to occupational pension schemes. Large numbers of them are therefore reliant solely on the state pension or Pension Credit.

Ground-breaking figures from the Family Budget Unit in 2006 showed a weekly budget needed to provide an acceptable/modest lifestyle for a single pensioner ranged between £123 and £181 depending on an individual's household costs[10]. Today, the NPC estimates that this range would be somewhere between £149 and £219. Echoing this figure, the Joseph Rowntree Foundation has also stated that a single person (but not necessarily a pensioner) needs at least £193 a week (excluding rent) to reach a minimum standard of living[11].

The NPC's longstanding policy of calling for a basic state pension, for all older people regardless of National Insurance contributions, at least equivalent to the recognised poverty level continues to therefore be the most practical and necessary to cover the day-to-day needs of older people.

Financing an improved state pension

The current economic crisis provides an almost unique opportunity to reassess how, as a society, we provide for our retirement. Like many other European countries, it is time we recognised the inherent weaknesses of our over reliance on means-testing and the private pensions system, and instead concentrate on strengthening the existing state pension by moving towards a Citizen's Pension funded through National Insurance as the most effective way of tackling pensioner poverty, both now and in the future.

In particular, a number of key improvements could be made:

- Increasing the basic state pension for all existing pensioners (regardless of contributions) to the official poverty level. This would largely remove the need for means-tested Pension Credit support for all but a very small number of individuals unable to meet the citizenship criteria[12]. The main gainers would be those, particularly women, who do not currently have a full contribution record.
- Introducing a new form of indexation for the basic and second state pension, linking it annually to average earnings, RPI (Retail Price Index), CPI (Consumer Price Index) or 2.5% (whichever is the greater) so that its value is maintained for the future and pensioners share in the rising prosperity of the nation.

[9] DWP Households Below Average Income 2006/7
[10] Low cost but acceptable budget for pensioners, Family Budget Unit, April 2006
[11] A minimum income standard for the UK in 2012, Joseph Rowntree Foundation, July 2012
[12] The state pension would move towards becoming a Citizen's Pension funded through National Insurance, but based on residency of say 30 years, rather than contributions

- Retaining the State Second Pension (S2P) as a good earnings-related pension for all workers, maintaining the higher replacement rate for the low paid. This would be paid to everyone with a minimum of 7 years and a maximum of 50 years' contributions or credits.
- Maintaining the state retirement age for men and women at 65 from 2020.

A House of Commons Library Paper dated 10 November 2011, shows the annual additional cost of giving everyone a basic state pension set at the official poverty level of £178 a week at £35.4bn. Despite claims that money is not available to make significant changes to our current pension system, there are various ways in which this funding could be made available, including:

- Using a greater proportion of the existing surplus balance of around £35bn in the National Insurance Fund, which has been paid in by today's employees and employers, as part of the pay-as-you-go system to cushion the introduction of the other measures necessary to raise the additional funds that will be required. This would still leave the legally required 16.8% balance to cover any additional expenditure.
- Abolishing the Upper Earnings Limit of £42,484 on National Insurance contributions, ending the injustice in which the higher paid contribute a smaller proportion of earnings than the lower paid. This would raise an estimated £10bn every year.
- Reforming the higher rate tax relief on private pensions which allows higher earners to pay less than the lower paid for a given contribution to their pension schemes. This currently costs the Treasury around £33bn a year (with a further £13bn given to employers who are exempt from National Insurance on the contributions they make to pension schemes)[13] – with the top 1% of taxpayers receiving around 25% of the rebate, whilst the average employee receives just £330 a year. This is neither the most effective nor equitable way of using public money, giving a massive incentive to save to those who least need it.
- Largely reducing the scale of the means-tested Pension Credit and the level of demand for Council Tax and Housing benefit would raise around £10bn annually.
- Enabling additional contributions planned for the National Employment Savings Trust to go towards an enhanced State Second Pension for those currently without an occupational pension, rather than into the private pensions industry. This would raise an estimated £12bn[14].
- The current equalisation of women's state pension age at 65 in 2020 is also set to save up to £10bn in delayed payments.
- Between £34bn and £120bn a year is currently uncollected, avoided or evaded in taxation, mainly from large corporations and businesses[15].
- Where necessary, Treasury grants can also be made into the National Insurance Fund to pay for expenditure.

[13] HM Revenue and Customs, March 2012
[14] A 4% contribution from 6m workers on average wages of £25,000pa, plus their employers' 3% contribution and tax relief of 1% would amount to £12bn each year
[15] The Missing Billions – The UK Tax Gap, TUC, 2008 and There is an alternative – the case against cuts in public spending, PCS, 2010

Proposal for a single-tier state pension

The government has announced its intention to produce a white paper later this year which will propose the introduction of a single-tier state pension from 2015/16. Based on previous information, the proposal can broadly be summarised as follows:

Flat-rate single-tier pension

- Thirty years of National Insurance payments/credits required to qualify for full State Pension of around £140 a week (at today's prices)
- State Pension uprated each year by triple guarantee (higher of earnings, CPI or 2.5%)
- Minimum qualification of 7 years of National Insurance or credits required to receive a proportion of the £140 a week
- No special rules for marriage, bereavement or divorce – everyone would qualify as an individual
- State Second Pension, contracting out and Savings Credit would end
- Some form of means-tested support would continue for those unable to meet the 30 year contribution rule, but this is not clear

The proposal to introduce a new state pension system just for those that retire after 2015/16 will effectively create three different pension schemes based on year of birth. Existing retirees will have a combination of first and second state pensions based on either 30, 39 or 44 years' worth of National Insurance contributions, those retiring after 2015/16 for the next few decades will have a combination of the existing system and that the new single-tier pension whilst those retiring around 2080 will be among the first with a state pension income based purely on the new system. It therefore suggests well over half a century of bureaucracy and complication before any real form of simplification is introduced.

The setting of a combined basic and second state pension at around £140 a week is already less than the amount those pensioners with a full entitlement to a basic state pension, Graduated Pension and SERPS are currently getting. In addition, it is even less than the amount available to someone who retires today – which on current figures would give someone with 30 years' worth of national insurance contributions a combined basic and second state pension of around £150 a week.

The government has also yet to explain how the proposal would impact on the entitlement to other benefits. Set around the existing level of the Pension Credit, individuals on the new pension would clearly cease to be eligible for additional support. However, Pension Credit Guarantee is currently a 'passported' benefit that entitles the recipient to automatic help with their council tax and housing costs, as well as other items. If this entitlement were to be removed, many would suffer a huge loss incurred through the removal of Council Tax and Housing benefit.

Despite some of the claims, none of the proposals would end the means-tested Pension Credit system for those who were unable to reach 30 years' worth of national insurance contributions. In effect this will mean maintaining some form of means-tested support even after the single flat-rate pension has become established.

The government has proposed an early end to contracting-out of occupational schemes. This would hit members, and sponsoring employers, by increasing their contributions. In turn this would lead to higher opt-out rates and remove a major incentive for employers to provide defined benefit (DB) pensions. The Green Paper recognises the sharp increase in National Insurance contributions that employers and employees in contracted-out schemes would face - 3.4 per cent of band earnings for employers and 1.4 per cent of band earnings for employees. Given this it is likely that employers would simply scale down their schemes to compensate for this loss. In reality, it would be yet another reason for employers to review the pension provision that they offer to their employees. The result could be the final nail in the coffin for defined benefit provision in the private sector, as employers move to defined contribution provision.

However, the real problem with the proposal is that the government has asserted that any reforms must be cost neutral in each and every year[16]. Given that none of the proposed reforms will seriously reduce the need for means-tested support for pensioners up to 2016, and yet will create a complicated and bureaucratic pension system that has to operate for at least the next 70 years, it is unclear how any changes would actually be financed. By fully honouring accrued pension rights, whilst making a commitment not to increase spending, it must surely be the case that there will have to be both pension winners and losers under the new system.

The decision to exclude existing pensioners from the proposals will mean that the biggest losers will be those 5m existing older women who do not have a full record of paying National Insurance and currently get less than £140 a week. The government accepts that it would cost around £1bn to include those women in the new proposal, and increase their income as a result. Whilst the single-tier pension may not therefore be as much as some existing pensioners are getting, those that would gain from it must be included in the change.

On balance the Green Paper acknowledges that whilst those on low pay and people currently excluded from additional state pension, such as women and the self-employed might gain from the single-tier pension, the loss of Savings Credit and reform of inherited rights would also disadvantage some within these groups.

Given that the government's current proposals therefore offer limited detail and a very mixed picture as to those who would gain or lose as a result, it is vital that a more equitable alternative is found. Not only that, but it is also likely that ministers will focus all their attention on the new proposals, and in effect abandon any attempts to improve the situation for existing pensioners. That is why it is vital that the campaign continues for a strengthened state pension system which could ensure real financial security for everyone in retirement, and end the reliance on means-testing and the private pension industry.

How we provide for ourselves in later life is a crucial test of how well society is organised. The principle of social insurance and shared collective provision is one which best protects

[16] A state pension for the 21st century, DWP, 2011

us all from the scandal of pensioner poverty. That is why a universal citizen's pension set above the poverty level, coupled with a strengthened state second pension and a retirement age of 65 for men and women is the way to create a decent state pension system for the 21st century.

The effect of taxation on pensioners' incomes

The latest official figures show the number of pensioners paying higher rate tax is 210,000, compared to 4.6m (41%) paying the standard rate and 6.5m (59%) paying no tax at all.

In the March 2012 Budget statement, the Chancellor announced that from 9 April 2012 the basic personal allowance for Income Tax would rise from £7475 to £8105. The personal allowance for someone aged 65 to 74 would rise from £9940 to £10,500 and for someone aged 75 or more the rise would be from £10,090 to £10,660.

However, the Chancellor also overturned a commitment he had made a year earlier to link age related personal tax allowances to the Retail Price Index, by saying that he would freeze the age-related allowances from 6 April 2013 at these levels until they align with the ordinary personal allowance. Those retiring after that time (born after 5 April 1948) will therefore receive a lower personal tax allowance of £9205. This measure is expected to save the Exchequer £3.3bn by 2016/17, and according to official estimates will result in 4.4m existing tax paying pensioners losing between £63-£83 a year, whilst future pensioners will suffer a loss of between £285 and £322 after tax[17].

By contrast, those pensioners with an income in excess of £29,390 will have their tax bill reduced in real terms by £155-£171, and those below pensionable age earning more than £150,000 a year will see their tax drop next April from 50% to 45% - giving some of them a maximum £10,000 windfall. In this way it could be argued that pensioners on very modest incomes are effectively subsidising a tax cut for the super-rich.

Whilst there is merit in the long-term policy objective of securing a single personal tax allowance based on income rather than age, there must also be a recognition that the age-related personal tax allowances were designed to help with those additional expenses one is faced with when older, such as home maintenance, and continue to be relevant for as long as the state pension remains completely inadequate.

A much fairer way of achieving this would be to uprate the age related allowances by inflation and the under 65 allowance by more than inflation so that over time the two would eventually harmonise and those older people affected would continue to get an increase in their allowance.

In addition, there remains an urgent need for further adjustments to the taxation system to ensure that those on higher incomes pay a fairer proportion of tax on their earnings.

[17] Budget Report, HM Treasury, March 2012

The relationship between an increased state pension and entitlement to benefits
Since the early Victorian days of means-testing and the concept of a 'deserving poor', governments have struggled to achieve a 100% take-up of benefits. Moreover, the very poorest in society who were supposedly meant to gain from a targeted approach are often the very ones who do not claim.

In 1993, Gordon Brown announced that he wished to achieve that which no other politician had done before, and end the means-testing of Britain's pensioners. Despite this claim, on gaining power in 1997, he became the architect behind the biggest expansion of means-testing since WWII; firstly through the minimum income guarantee and later with the fiendishly complex Pension Credit.

After a decade, attempts to relieve poverty by expanding the use of means-testing have failed to reach those most in need, with take-up figures showing around 1.8m eligible pensioners having yet to make a claim – and at least £5bn remaining unclaimed every year.

It is widely understood that people's income declines as they get older, often as a result of poor pension indexation and rising costs of living. Whilst someone may therefore begin retirement above the threshold of means-tested support, over time it is likely they could become eligible, yet the targeted approach often focuses on those entering retirement rather than older pensioners. Moreover, the very poorest in society who were supposedly meant to gain from a targeted approach, are often the very ones who do not claim. For reasons that have been well-documented such as complexity, inaccessibility, social stigma and a reluctance to deal with officialdom, it is clear that means-testing and pensioners simply do not mix.

One of the side effects of means-testing has been the unfairness it creates for those whose incomes are just above the eligibility threshold. For example, whilst those in receipt of Pension Credit can also gain access to Council Tax benefit, those 'nearly poor' have to find the money to pay these bills in full. The net effect is that their disposable income may end up being well below such poverty or benefit thresholds. A more radical approach would therefore be to award the state pension in a way and at such a level that no longer required the Pension Credit to continue.

However, since a significant number of older people are currently in receipt of means-tested support, it is only right to consider whether or not raising the state pension above the official poverty level would actually make them financially better off. Appendix 1 offers a number of examples showing the effect on various types of pensioners. In all cases, there would be a net gain providing the state pension were raised to a suitable level. It should also be noted that all examples are based on 2010 figures and whilst these have been uprated by government since, the basic principle and findings have not altered. In addition, all examples assume tapering of means-tested benefits remains at current thresholds, all examples provide an income that is below the current personal tax allowance threshold and examples of housing costs assume £150 rent for a two bedroom, semi-detached property in Reading.

The National Insurance Fund
For a number of years, politicians of all shades have been denying the very existence of the National Insurance Fund. Some even claim it is simply an accounting tool; a notional fund that bears no relation to improving the state pension. But for millions of employers and employees who make contributions every month, and for the payment of state pensions and part of the NHS, this argument simply doesn't stand up to scrutiny.

The National Insurance scheme was established on 5 July 1948 to provide unemployment benefit, sickness benefit, retirement pensions and other benefits where individuals meet the contribution and other qualifying conditions, such as the annual Christmas Bonus.

Currently, employees contribute 12% of income between £145 and £854 a week and 2% above £854. Employers pay 12.8% on all income above £94. Employees contracted-out of the state second pension get a NI rebate of 1.6% of earnings between £145 and £854, and their employers get 1% to 3.5% depending on their scheme.

From these contributions an allocation is made towards the NHS of 2.05% of the first slice of eligible earnings from employees and the full 2% on income above £854. Employers pay 1.9%. The remainder goes into the fund, and can only be used for the payment of benefits or the cost of administration.

In principle, the National Insurance Fund operates on a pay-as-you-go basis, the contributions received in each year being used to pay pensions and other benefits in the same year. In this respect it differs fundamentally from private pension funds, which need to build up reserves to cover their future liabilities.

The Government Actuary, who reports on the state of the Fund each year, also recommends that the Fund should also keep a balance to cover any unexpected short-fall in income of not less than two months' benefit expenditure.

The NPC has long argued that the money in the NI Fund should primarily be used for its original purpose of paying pensions and benefits – but for at least a decade, successive governments have been borrowing from the surplus balance in order to spend on other items of public expenditure.

The pensions' minister, Steve Webb, explains the current thinking, and in doing so, shows the weakness of the government's position. In a letter dated 9 September 2010, Mr Webb states:

"The National Insurance fund is run on a pay-as-you-go basis. This means current income, mainly from National Insurance contributions, pays for current expenditure. However, there is no 'fund' in the sense normally meant – that is, there is no pot of money invested in stocks and securities."

"Under long-standing legislation, contributions paid in can only be used for contributory benefits and where any 'surplus' exists – it is held in a short-term investment account run by

the Commissioners for the Reduction of the National Debt. This means the government will borrow less from elsewhere."

In a few sentences Mr Webb admits there is a surplus in the fund – and that the government is borrowing from it in order to reduce borrowing from other sources. What he didn't say is that according to the Commissioners for the Reduction of the National Debt (CRND), the latest surplus predicted at the end of March 2012 was around £38bn. In actual fact, it was just over £37bn and at the end of June 2012 it stood at £35.1bn.

It is quite clear that millions of pensioners, workers and their employers have no idea that the money being paid in National Insurance every month is not being used to pay higher pensions and benefits – but is instead being used to balance the government's books. As a direct result, the state pension is being kept unacceptably low and millions of older people are facing financial difficulties.

It's time the government stopped using NI as just another form of general taxation, owned up about the way it is using the fund and started to use the surplus to raise the basic state pension and strengthen the existing NI based pension as the most effective way of tackling pensioner poverty, both now and in the future.

Comparisons with other EU countries

According to the latest figures from the Office for National Statistics, British pensioners are among Europe's poorest, with more than two million older people at risk of poverty. The UK was ranked fourth out of 27 European countries, with more than one in five (21.4 %) of older British people classed as being at risk of poverty in 2010; "significantly higher" than the EU average of 15.9%.[18]

The main reason for this situation stems from the UK's inadequate state pension system. According to the latest EU comparisons, the adequacy of the UK state pension in relation to the country's average wage ranks it at the bottom in a list of 25 European countries. For the average earner, the UK replacement rate of 17% is far below the EU average of 57%. Only for those on means-tested benefits, do the replacement rates start to approach other countries. Yet the UK's ability to sustain better state pensions is widely acknowledged[19].

What this latest information shows is that the UK has had a state pension that has been systematically cut over the years, whilst successive governments have sought to offload responsibility on to the private sector. This is borne out by the fact that Britain currently spends around 6.5% of Gross Domestic Product (GDP) on state pensions, 0.5% less than the OECD average.

Indexation of pensions

In the Emergency Budget on 22 June 2010, the Chancellor announced that the government would use the Consumer Price Index (CPI) instead of the RPI (Retail Price Index) for annual up-ratings of elements of the second state pension, benefits and tax credits from April 2011, and since then the CPI has also been applied to the basic state pension and around 60% of

[18] Comparison of UK and EU at risk of poverty rates, ONS, June 2012
[19] European Pensions Barometer Report, AON, 2007

defined benefit/final salary private pension schemes that do not specify RPI in their rules. The change from RPI to CPI clearly therefore affects both existing pensioners and workers through their state pensions and benefits, as well as their public or private occupational pensions.

This change is in breach of pre-election assurances that there would be no changes to index linking; contractual obligations freely entered into by government as an employer and the Secretary of State's obligation under Section 59 of the Social Security Pensions Act 1975 and Section 151 of the Social Security Administration Act 1992 to increase pensions in line with the "general level of prices".

On average, each year the CPI has been about 0.8% less than the RPI and the Office for Budgetary Responsibility has recognized that unless the CPI and RPI are revised the gap might grow to about 1.4%. Whilst the difference might seem small, the compound interest will have a major effect on pensions.

Over the past 15 years, if pensions had been increased by only CPI, they would now be worth 13% less than they are now, having been increased in line with the RPI. Lord Hutton, in his Review of Public Sector Pensions, has estimated that a change to CPI could cost us up to 25% of our pensions over a lifetime.

The use of CPI is contentious because it assumes that, if the prices of particular product increases, then consumers will buy cheaper alternatives. Given that many pensioners are already likely to be buying the cheapest products and will have little scope of finding cheaper substitutes, it is a gross exaggeration to argue that CPI therefore protects the purchasing power of pensions.

At present, the Office for National Statistics is reviewing how best to include owner occupier housing costs and the extent to which consumers do, in fact, trade-down to cheaper products when prices rise in a revised inflation measure. The review is likely to lead to a higher CPI and a slightly lower RPI.

However, the NPC continues to support the case for indexation to be based on the greater of CPI, RPI, average earnings or 2.5%.

State Pension Age and Retirement
Alongside changes to the state pension system, the government has also announced that a proposal to automatically raise the state pension age (SPA) in line with longevity and estimates of life expectancy will be published in the summer. Women have already seen their SPA rise rapidly by five years in the period from 2010 to 2018 and now ministers want to accelerate increasing the state pension age for men and women to 67 from between April 2026 and April 2028, and based on an initial analysis of the government's long-term proposal, someone currently aged 33 would not qualify for a state pension until 70, whilst a 21-year-old would have to work till 75.

Since the recommendations in the Turner Commission's final report in 2005 and the subsequent legislation in the Pensions Act 2007, the argument for raising the state pension age has been promoted by those who see it as a way of tackling the scale and complexity of the demographic challenges posed by an ageing population. Some have described this challenge as being as significant as global warming – claiming that an ageing population will place an intolerable financial burden on the working population. What is worrying is that these widely expressed ideas are shaping and influencing future social policy; yet they are seriously flawed.

Much of the information that surrounds this debate tends to use data and statistics to support – either implicitly or explicitly – the case for rationing or cutting public spending, rather than as a justification for improving services. The ageing population is now cited widely by politicians, the media and other commentators as one the main reasons why the government has to introduce widespread cuts. However, although Britain, like most industrialised countries has an ageing population, this is by no means a new development. Since the early 20th century, improvements in medicine and public health have led to a steady increase in the proportion of older to younger people. During this time technological and economic advances have raised both the employment rate and the productivity of the working population generally, and as a result the nation's wealth, measured by the Gross Domestic Product (GDP), and that of individuals, has also increased. To argue that an improved state pension system is unaffordable simply by looking at the age structure of the population is therefore both simplistic and historically inaccurate.

The 'panic' surrounding the prospect of an ageing population has also been over stated. The UK is expecting a 2% increase in the number of people over retirement age between 2009 and 2050; which will take the number of pensioners to 16m; representing 21% of the entire population over a forty year period[20]. It is therefore highly questionable that such a relatively minor change is being used to introduce such far reaching and detrimental policies.

Government ministers have been keen to suggest that that life expectancy "is a staggering 89 for men and 90 years for women." However, they are slow to point out that this figure refers to life expectancy for those born in 2008 – not existing adults.[21] By contrast, the Office for National Statistics in October 2010 issued data showing that life expectancy in the UK at age 65 in 2006-08 was 17.4 years for males and 20 years for females. Therefore, men could be expected to live to 82.4 years and women to 85, not exactly their late 80s in either case.

There is also a difference between life expectancy at birth and life expectancy at 65 – as well as a difference between healthy life expectancy and disability-free life expectancy. In fact, all the figures show that disability-free life expectancy is not rising anywhere near as fast as life expectancy itself. It is therefore vital that some of the arguments used to support the existing approach to an ageing population are scrutinised more closely.

A Department for Work and Pensions' (DWP) discussion document, Preparing For Our Ageing Society, published in 2008, stated:

[20] www.gad.gov.uk, ONS, 2006
[21] The Guardian, 22 September 2010

"Within 20 years half of the adult UK population will be over 50. One in four children born today will live beyond 100. These are dramatic shifts that have far-reaching consequences for us all, and our ageing population will change our society in many ways."[22]

However, researchers from the Open University have pointed out how this debate is often framed to suit a particular view. Specifically, they suggest the personalisation implicit in the claim that one child (in four) born 'today' will live to reach 100, overlooks the future of the other three. There is no qualification regarding the predictions being made, but they are given as a statement of fact that they will happen[23].

Similarly in 21 August 2008, the Office for National Statistics issued a press release regarding the rise in UK population figures. Within it was, on first glance, the rather innocuous statement that:

"For the first time ever, there are more people of state pensionable age than under 16s."

However, it is quite clear that the political implications of such claims are that an ageing population implies increased costs in providing health care, pensions and housing. This in turn can then be used as justification for making changes to welfare and other state support. We are led to believe that we should be concerned that for the first time ever, there are more old people than children – all depending on people of working age to support them. But in reality the reverse is often the case: people of working age depending largely on the unpaid work undertaken by pensioners to provide childcare and voluntary organisations depending on them to maintain the functioning of our civil society.

For example, a recent survey showed that almost half of all employees depended on their parents to help with childcare so that they could go out to work[24]. The truth is that the unpaid financial contribution that older people make to the economy is never taken into account. New research by the Women's Royal Voluntary Service shows that the net contribution made by older people to society is £40bn every year in taxes, unpaid caring and voluntary work[25]. The report also revealed how older people are often the social glue - making an active contribution to their local communities through volunteering.

The longevity debate

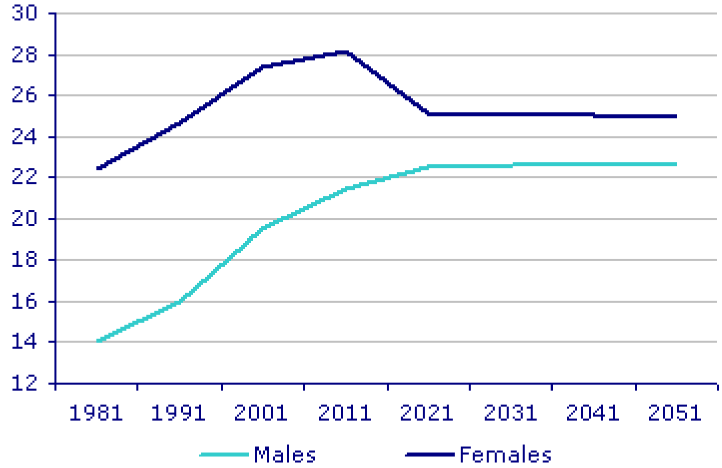
Despite numerous reports in the media and statements from politicians of all shades, the issue of longevity is more complex than the way it is often portrayed. There is an unsupported claim that everyone is living longer, healthier lives and that life expectancy is, and will always, continue to increase.

However, evidence suggests this is far too simplistic a way of looking at the issue. Recent figures from the Office for National Statistics (ONS) show that life expectancy at state pension age is expected to level off between 2021 and 2051 for both sexes. During this

[22] Preparing For Our Ageing Society, DWP, 2008
[23] Bill Bytheway and Julia Johnson, Centre for Ageing and Biographical Studies, Open University, Radical Statistics 100, 2010
[24] www.workingmums.co.uk, 2010
[25] Gold Age Pensioners, Prof Robert McNabb, Cardiff Business School, WRVS, 2011

period, the number of extra years at 65 are projected to be 22 for men and 25 for women[26] (see Figure 1):

FIGURE 1



Projected principal period of life expectancy at State Pension Age: by sex, 1981 to 2051
Source: ONS

Obviously, whilst life expectancy has increased over the last 50 years, there is still a limit to longevity because of the physical ageing process. Similar ONS data also shows that the period of average life expectancy at birth in 2006-08 in the UK was 77.4 years for a man and 81.6 years for a woman[27].

But longevity is not an issue that affects everyone equally. The ONS also states that in 2002-5, people at age 65 in the top social class group (professionals such as doctors, accountants and engineers) could expect to live 4.2 years longer than those in the bottom social class group (unskilled manual labourers)[28].

In the recent Marmot Review, researchers also found a clear link between affluence and length of life. The review found that in England, people living in the poorest neighbourhoods will on average die seven years earlier than those in the richest neighbourhoods, and the average difference in disability-free life expectancy is 17 years. Those in poorer areas not only therefore die sooner, but they will also spend more of their shorter life with a disability. The report concluded: "The higher one's social position, the better one's health is likely to be"[29].

This view is echoed by recent district by district NHS figures which show that men in Blackpool live on average to 73.2 years – 10.5 years fewer than their counterparts in Kensington and Chelsea, whilst women in Hartlepool have the lowest life expectancy of 78.1

[26] ONS, Pension Trends, Life Expectancy and Healthy Ageing, Chapter 3, 25 June 2010
[27] ONS, News Release, 21 October 2009
[28] ONS, Pension Trends, Life Expectancy and Healthy Ageing, Chapter 3, 25 June 2010
[29] Fair Society, Healthy Lives, The Marmot Review, February 2010

years; 9.6 years less than women in Kensington and Chelsea[30]. It is therefore clear that life expectancy rates are rising much faster in affluent areas.

Much more therefore needs to be known about the years of healthy life expectancy rather than simply length of life. Contrary to popular perceptions, healthy life expectancy has not increased at the same rate as life expectancy and a greater proportion of retirement is now spent in ill-health[31]. The Department for Work and Pensions' own figures show that 47% of retired people have a disability, including those with a limiting long standing illness, and of the existing working-age population, a staggering 23% are permanently sick or disabled[32]. This is clearly not a generation that has the ability to simply keep working. Current concerns about the rate of obesity amongst young children, the prevalence of poor diets, lack of exercise and increased stress must also surely raise doubts as to the health of future generations and the likelihood that they will live longer than today's retirees.

In fact, on closer examination, there is no solid reason to assume that the trends of medical advances, increased affluency and increased longevity will continue at their current rate. Indeed there is evidence that advances in health are now going into reverse[33].

In a modern society people in different social circumstances experience avoidable differences in health, well-being and length of life. The evidence is quite clear that any attempt to raise the state pension age will therefore have a disproportionate impact on those members of society with the lowest incomes and the poorest health. It is simply unfair to therefore build a retirement policy which fails to take account of this important issue, alongside the rate of unemployment and availability of work, the rights of younger people to find a job and the loss to wider society if pensioner volunteers (currently undertaking unpaid caring and charitable work) were otherwise in paid employment.

Of course we should celebrate the fact that social progress now enables people to live longer, but we must also recognise that the right to retire can only really be exercised when individuals have financial security as well. Otherwise working longer becomes a necessity for many rather than a choice. Rather than therefore raising the retirement age, we should be addressing the problem of low income through an improved pension system. In effect, by removing the right to a decent period of retirement for ordinary working people, we are accepting the myth that increased longevity necessarily enables people to work longer, and that an individual's only worth is measured through their ability to be economically productive.

The pension outlook for future generations

If the current pension system is failing existing pensioners, the outlook for future generations is little better. When occupational pension schemes were first introduced into the workplace more than 50 years ago, there were more contributors than those retired members drawing a pension. However, over the decades little consideration was given as to

[30] The Politics of Pensions, NPC, 2010

[31] Increasing Longevity and the Economic Value of Healthy Ageing and Working Longer, L Mayhew, Cass Business School, 2010

[32] Family Resources Survey 2008-09, DWP, 2010

[33] Today's teenagers are less healthy than their parents, J Laurance, The Independent, 27 March 2007

whether the amount going into the schemes, from either employers or employees, was sufficient to cover their long-term obligations. For example, today the deficits of the BT and British Airways pension schemes are greater than the value of the companies to which they belong.

For those currently paying into an occupational pension scheme and new recruits that are still entitled to join, the future also looks rather bleak. Millions of people nearing retirement already face a pensions' disaster because of the recent economic crisis. An estimated 5m workers are currently paying into defined contribution/money purchase schemes. These defined contribution pensions invest in a mix of shares, property, cash and bonds, but more than 90% of people opt for the default fund, where between 75 to 100% of investment is in shares.

Research from private pension provider Scottish Widows also shows that 47% of those aged between 30 and 50 are not saving enough for their retirement, with a fifth saving absolutely nothing[34]. It is suggested that individuals would need to build up a pension pot of around £425,000 in order to have an annual private pension income of £24,000, but for millions of workers this is simply not possible. The Department for Work and Pensions estimates that around seven million people are not saving enough for their retirement, but the real savings barrier they face is that they lack sufficient income to put aside at the end of the month after having paid their normal living expenses[35].

According to the Department for Work and Pensions, the average amount received from an occupational pension (both defined benefit and defined contribution) per week is £79 for a single pensioner and £166 for a couple[36], but 27% of existing pensioners have no occupational pension whatsoever[37]. Research also shows that whilst 71% of men aged over 65 had either an occupational or personal pension, for women the figure was just 43%[38]. Therefore, given the switch from final salary to less generous and volatile money purchase schemes, the scale of the shortfall in many existing pension funds, the long-term damaging effect that the shift from the RPI to the CPI will have on many occupational schemes and the high level of those who are unable to put aside sufficient additional savings, it is imperative that the state pension system be radically reformed. However, rather than adopt this approach, the government is pursuing a new voluntary savings scheme known as auto-enrolment.

Auto-enrolment pensions

The PIWP produced a detailed briefing paper on the NEST (National Employment Savings Trust) in November 2011, which was subsequently endorsed by the Executive Committee. Whilst NEST is only one of the auto-enrolment schemes now being offered, many of the issues surrounding it can be equally applied to other schemes as well.

[34] 7th Annual Scottish Widows UK Pensions Report, June 2011
[35] Security in retirement: towards a new pensions system, DWP, 2006
[36] The Pensioners' Income Series 2009/10, DWP, 2011
[37] Households Below Average Income Series, Chapter 6, June 2012
[38] Arber, S and Ginn, J Ageing and Gender, Diversity and Change, Social Trends 2004

Auto-enrolment pensions are the new personal (defined contribution) pension schemes aimed at between 3-6m low-average paid employees who currently do not have access to an appropriate workplace pension. The new schemes will be phased in from October 2012, starting with the biggest employers and is expected to be completely rolled-out by 2017.

All employees above the PAYE threshold of £7500, regardless of the size of their employer's business, will be automatically enrolled in an occupational pension scheme unless they actively choose to opt out or they already have an occupational pension that is superior. For those whose workplace scheme does not meet certain requirements, NEST will become the default scheme. Those aged below 22 or earning less than £5000pa in a single job will be excluded from the schemes, even if their combined income from several jobs amounts to over £5000. Those earning between £5000 and £7500 may volunteer to join a scheme and if so, their employer will have to make a contribution. Those earning less than £5000 can still opt-in, but their employer is not required to make any contributions.

Contribution levels will be phased in, starting with a minimum 1% of band earnings from each of employer and employee, with a further 1% from the government through tax relief, making 3% in 2012. This will rise to 8% by the time all employers have signed up to the scheme, assumed to be by 2017. At this stage the employer will have to contribute 3%, the employee 4% and there will be an additional 1% of tax relief.

The NPC has always been critical of auto-enrolment and instead has championed an improved universal basic state pension alongside a state second pension for all workers, maintaining the higher replacement rate for the low paid and including contribution credits for those caring for others.

Our main criticisms are as follows:

- The scheme exposes low paid workers to an unacceptable financial risk
- The interaction between auto-enrolment schemes and means-tested benefits (Pension Credit, Housing and Council Tax Benefit) is unclear. Without a universal state pension set substantially above the Pension Credit, it is doubtful whether additional saving would be worthwhile
- There are no credits in auto-enrolment schemes for time spent out of employment due to childcare and eldercare, perpetuating carers' income disadvantage
- Small pension pots of those with low lifetime earnings will generate poor annuity rates and low payouts. There should at least be the ability to combine all small pension pots as recommended by the Workplace Retirement Income Commission
- There will be pressure on employers to minimise the wage bill in order to reduce pension contributions, which will have a greater adverse effect on those who have opted-out of the scheme
- Employers will tend to reduce occupational scheme contributions to the minimum legal level of 3%
- The main gainers from the auto-enrolment schemes will be the private pension industry and the City. With the poor track record of pension delivery to ordinary workers, it is unwise for government to rely on the same providers to make these new schemes a success.

Placing the provision of a decent income in retirement for future generations of pensioners in the hands of either employers or the financial markets is an expensive folly. If it is desirable to encourage additional second tier pension saving with voluntary contributions from employees and employers, this could be operated through an auto-enrolled Voluntary Earnings-related State Pension Scheme (VESPA) with credits for caring as in NI.

The state pension system is a valuable levelling force across occupations and also redistributes fairly towards those who have family caring responsibilities. The means exist to provide lifetime financial security for everyone and not just the very rich, through a suitable state alternative. What is required is the political will to do so.

Conclusion

Everything in the UK pensions' landscape supports the case for a stronger state pension and the issue will therefore continue to be important for those both in and retired from employment. There are very striking inequalities and disadvantages for millions of existing and future pensioners, but a strengthened state pension system could ensure real dignity and financial security for everyone in retirement, and end the reliance on the private pension industry and the risks it takes with the retirement prospects of millions of ordinary people.

Effectively the pensions policy being pursued by government, encouraged by the financial markets and private pensions industry, and largely unrecognised by the workforce, is one which privatises risk – passing insecurity and uncertainty from the state and the employer onto the individual. Yet the harmonious functioning of our society relies – not on such individualism – but on shared common values and collective provision. The politics of pensions are in essence, therefore, the politics of our society and the way in which we think it should be organised and run. That is why decent state pensions are worth fighting for.

APPENDIX

Impact on overall income and entitlement to means-tested support from raising the basic state pension above the official poverty level for each individual

Example A: Single Pensioner on full Pension Credit

1. Working assumptions:
Council Tax is £1050 per annum (£1400 less 25% for single occupancy)
Rent is £150 a week

2. Individual receives (weekly):
Basic State Pension: £97.65
Savings income/SERPS/Occupational Pension etc: £0
Maximum Pension Credit (Guarantee): £34.95
Savings Credit: £0
Maximum Council Tax Benefit: £20.19
Maximum Housing Benefit: £150

3. Basic state pension is then increased from £97.65 per week to £175 (estimated poverty level in 2010)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the individual would lose:

£34.95 Pension Credit (Guarantee)
£4.28 Council Tax Benefit (but still receive £15.91)
£13.93 Housing Benefit (but still receive £136.07)
Total loss £53.16 per week

5. However, this would be offset by an increased basic state pension of £77.35, resulting in a net gain of £24.19 a week

Example B: Single Pensioner on full Savings Credit
1. Working assumptions:
Council Tax is £1050 per annum (£1400 less 25% for single occupancy)
Rent is £150 a week

2. Individual receives (weekly):
Basic State Pension: £97.65
Savings income/SERPS/Occupational Pension etc: £34.95
Pension Credit (Guarantee): £0
Maximum Savings Credit: £20.97
Maximum Council Tax Benefit: £20.19
Maximum Housing Benefit: £150

3. Basic state pension is then increased from £97.65 per week to £175 (estimated poverty level in 2010)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the individual would lose:

£20.97 Savings Credit
£11.28 Council Tax Benefit (but still receive £8.91)
£36.68 Housing Benefit (but still receive £113.32)
Total loss £68.93 per week

5. However, this would be offset by an increased basic state pension of £77.35, resulting in a net gain of £8.42 a week

Example C: Pensioner Couple on full Pension Credit
1. Working assumptions:
Council Tax is £1400 per annum
Rent is £150 a week

2. Couple receives (weekly):
Basic State Pension: £156.15
Savings income/SERPS/Occupational Pension etc: £0
Maximum Pension Credit (Guarantee): £46.25
Savings Credit: £0
Maximum Council Tax Benefit: £26.92
Maximum Housing Benefit: £150

3. Basic state pension is then increased from £156.15 per week to £350 (2 x £175)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the couple would lose:

£46.25 Pension Credit (Guarantee)
£23.97 Council Tax Benefit (but still receive £2.95)
£77.90 Housing Benefit (but still receive £72.10)
Total loss £148.12 per week

5. However, this would be offset by an increased basic state pension of £193.85, resulting in a net gain of £45.73 a week

Example D: Pensioner Couple on full Savings Credit
1. Working assumptions:
Council Tax is £1400 per annum
Rent is £150 a week

2. Couple receives (weekly):
Basic State Pension: £156.15
Savings income/SERPS/Occupational Pension etc: £46.25
Pension Credit (Guarantee): £0
Savings Credit: £27.75
Maximum Council Tax Benefit: £26.92
Maximum Housing Benefit: £150

3. Basic state pension is then increased from £156.15 per week to £350 (2 x £175)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the couple would lose:

£27.75 Savings Credit
£26.92 Council Tax Benefit
£110.40 Housing Benefit (but still receive £39.60)
Total loss £165.07 per week

5. However, this would be offset by an increased basic state pension of £193.85, resulting in a net gain of £28.78 a week