John Hills

Pensions, public opinion and policy

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Chapter 11

PENSIONS, PUBLIC OPINION AND POLICY

John Hills

"The trouble with the British is that they want European-level services with US levels of tax". This quotation, from *Wall Street Journal* coverage of the UK General Election of 2001, was used by Howard Glennerster (2003, p 199) to illustrate one of the besetting difficulties facing UK policy-makers. The problem is that, in reality, 'someone has to pay', as he headlined an early section of his book on *Understanding the Finance of Welfare*. Pensions policy, and the current debate on how we cope with future pressures on pensions, illustrate both the difficulties associated with what may be unrealistic expectations and the unavoidable choices in working out who pays for a substantial part of the welfare state.

In May 2006, the Government published wide-ranging proposals for the long-term reform of Britain's pensions system, hailing them as, "a radical reform and the most important since Beveridge" (House of Commons Work and Pensions Committee, 2006, p 10). Some historians demurred.[1] The Fowler reforms of 1988 were similarly described – as have been many other social welfare reforms in the last fifty years. More to the point, the reforms associated with Barbara Castle that brought in the State Earnings Related Pension Scheme (SERPS) in the late 1970s could justifiably have been described in these terms. What is notable about the latest batch of reforms is that, with one crucial addition – the introduction of a low-cost system of additional funded pension accounts into which people will be automatically enrolled unless they opt out – their main effect is eventually to *return* the UK's pension system towards a flat-rate state pension system of a kind that would have been completely recognisable by Beveridge or the post-war Attlee government that introduced the reforms based on his proposals.[2]

None the less, the latest reforms do represent one of the most radical social policy changes for a generation, and with all-party backing for their main structure and a wide – if not universal – expert consensus behind them, the prospects currently look promising for their survival for longer than the typical UK pension system of the last quarter century. A key to this will, however, be whether public opinion will ultimately accept the painful realities the reforms crystallise, or whether we slip back to hankering after the hope that someone else will pay.

This chapter looks at the evidence on what the public wants from pensions, and at how people react when confronted with the potential ways of achieving it. The first section discusses why it became apparent that wide-ranging pension reform was necessary. The next section describes the recommendations made by the Pensions Commission (of which the author was a member) in 2005, the Government's reaction to them, and the reforms that are now being put into legislation. Subsequent sections discuss public attitudes to pensions in general, public views of the trade-off between the fundamental choices in tackling the pensions problem, and then specific views of how entitlement to state pensions should be 'earned'. For social policy to 'work' and reforms to stick, ultimately requires sustained public support. The conclusion discusses the long-term prospects for survival of the reforms in the light of these findings.

Changing perceptions of the pensions problem

There has been a remarkable change in both government and public perceptions since the Labour Government came into office in 1997. In its first pensions Green Paper (DSS, 1998), the emphasis was on tweaking the inherited structure. The aspiration was that in the long-run, pension flows would switch from an alleged 40 per cent of the total coming from the private sector and 60 per cent from the state to the reverse.[3] In this way, the same share of GDP (or even a falling one) for state pensions could be spread amongst a much larger number of future pensioners in the middle of the century, without their relative living standards falling. With the private sector assumed to be coming in to fill the gap, the Government said that the flat-rate 'basic' state pension (as established following Beveridge) could continue to be price-linked, as it had been since 1981. While the consequently ever-falling relative value this implied for it would leave a problem for low-paid workers, the rules of what had been SERPS and became the State Second Pension (S2P) would be tweaked to make them more generous to the low-paid, theoretically allowing them to avoid the need for means-tested top-ups in retirement.[4] There was no need to change State Pension Age. Part of the way that the switch from 40:60 to 60:40 in the contribution of the private sector would be achieved would be through sending people annual pension statements. The optimistic assumption at the time was that on realising quite how low their entitlements were, particularly from the state, at least some people would decide that they needed to save more.

Subsequent reforms to means-tested assistance for today's pensioners created the two-part Pension Credit. This both improved the value of the means-tested minimum for pensioners (the Guarantee Credit) and introduced an additional element (the Savings Credit), which assisted those just above the minimum level, removing some of the 100 per cent effective marginal tax rates people had faced on retirement income (but at the cost of extending shallower withdrawal over a wider income range).

The distance between the assumptions of that Green Paper and the May 2006 White Paper (DWP, 2006a) is considerable. What has changed? Five factors stand out. First, there have been substantial revisions to both public and private sector actuarial forecasts of future longevity. As recently as the 2002 population projections of the Government Actuary, the implicit assumption was that the continual improvements in age-specific mortality of recent decades would slow and then stop. Male life expectancy at 65 would, on the central projection, rise from about 17 years in 2002 to about 19 in 2050. The most recent projections made in 2005, suggest that the figure is already over 18 years, and would approach 24 by 2050 (Pensions Commission, 2005, figure 1.38). This – and the equivalent improvements for women – are good news for individuals, but represent a major headache for pension providers, whether public or private.

Second, in the late 1990s, both companies and the government assumed that generous private sector ‘defined benefit’ (DB) pension promises (for instance, those based on a percentage of final salary) were backed by adequate funds. The private sector had used apparent surpluses in their funds to finance restructuring through early retirement deals in the early 1990s, and the incoming Labour government could withdraw tax credits for pension fund investment income in 1997 without thinking that the system was unsustainable. The stock market crash after 2000 punctured this ‘irrational exuberance’. At the same time, both tighter regulation and lower inflation rates meant that pension providers had less room for manoeuvre in controlling their costs (for instance, through letting the real value of pensions in payment fall, as they had in the 1970s when there was a similar stock market fall).

Third, in reaction to both developments, the private sector started to retreat from the old DB schemes, telling new recruits that they would instead be members of ‘defined contribution’ (DC) schemes, where employees took the risks on both investment performance and future longevity. On average, that need not necessarily have implied a cut in generosity, but in fact contribution rates to DC schemes are far below the effective value of the old DB promises. Crucially, companies then found that they did not seem to suffer any great labour market (recruitment or retention) penalty from this change. As they realised that the old system was more expensive and far riskier than they had assumed, but did not seem to be valued by potential workers, the retreat from DB became a flood. While, so far, most existing members of private DB schemes have maintained their rights to accrue new rights for further years of work in the same way, some companies have already ended such new accruals, and many expect the most of the rest of the private sector to follow.

Fourth, what was being contributed to funded pension schemes was in any case far less than official and private statistics suggested. As recently as the 2004 national accounts *Blue Book*, the Office for National Statistics (ONS) believed that the inflow of new savings into funded pension schemes had risen from 4 per cent of GDP in the early 1990s to 6 per cent in 2002.[5] In fact, the flow had remained at just under 4 per cent of GDP throughout the period (PC, 2004, figure 3.49). One of the problems was that the considerable ‘churning’ of *existing* private pension funds between one provider and another was being classed by the insurance companies as ‘new business’, and so by ONS as new saving, when it was nothing of the sort.

Finally, levels of public trust in pension providers had plummeted (Taylor-Gooby, 2005). People had heard of private companies, such as Allied Steel and Wire, which had gone bankrupt without enough money in their pension funds to honour the promises made to their workers (although those who had already retired were partly protected). The difficulties of the Equitable Life insurance company in meeting the promises it had made to different kinds of investor were constantly in the news. Prospective returns on DC schemes plunged following the stock market collapse and the adjustment of annuity rates to improved life expectancy forecasts. People had not forgotten the Maxwell pension scandal of the early 1990s or ‘pension mis-selling’ in the 1980s. And people knew that the basic state pension was steadily losing its relative value. Faced with all this, instead of reacting to poorer than expected pension rights by saving more, many people appeared, in the words of another contributor to the volume, Nicholas Barr, to be “like rabbits trapped in the headlights” – aware that there was a problem, but unable to work out a safe way to turn.

While realisation of some of these developments lay ahead – indeed it partly emerged as a result of the Commission’s work – the Government was sufficiently concerned in 2002 to establish an independent Pensions Commission, chaired by Adair (now Lord) Turner. The brief of the Commission was to review the adequacy of private pension saving in the UK, and advise on appropriate policy changes, including whether there was a need to ‘move beyond the voluntary approach’. We started work in early 2003, produced a first report laying out the problems as we saw them in October 2004, a second report with our main conclusions and analysis in November 2005, and a short final report commenting on some of the issues arising in the debate on our recommendations in April 2006.

From the outset it was clear that to understand the adequacy of private pensions and the impact of policies towards them, the interface with state pensions had to be taken into account. This determines both the starting point from which private pensions could build towards an adequate level of provision, and the incentives (and perceived incentives) for people to build private provision on a voluntary basis. In the event, our recommendations and the Government's response in its May 2006 White Paper covered both private and state pensions.

Faced with developments of the kind sketched above, combined with the large gaps in existing coverage of pensions beyond the state's minimum for many low-paid workers, those working for small or medium-sized firms, and for many women with interrupted paid-work careers, the findings in the Commission's first report (2004, pp x-xiii) were clear:

- while the state had been planning to provide decreasing support for many people to control expenditure in the face of an ageing population, the private sector had not been developing to offset the state's retreating role. Instead it was in significant decline;
- given present trends, many people would face what they would see as inadequate pensions in retirement. While some would be well-provided for, many would not be: pension right accrual was both deficient in total and increasingly unequal;
- women in particular have much lower pension rights then men, with the state system based on assumptions about family structure which have ceased to be valid. An effective pension system for the future should be one where the vast majority of women accrue pension rights, both state and private, in their own right;

- there are big barriers to the success of a voluntary pension system, including inherent barriers of inertia in making complex decisions, high costs of individually-sold pension products, and the bewildering complexity of the UK pension system, state and private combined;
- mean-testing within the state system both increases complexity and reduces the incentives to save created by the tax system. The scope of means-testing would grow over time if recent indexation approaches had continued (with the basic pension price-linked, but the minimum given by Pension Credit earnings-linked);
- given all of this, it was unlikely that the present voluntary system combined with the present state system would solve the problem of inadequate pension savings.

Fundamentally, any country faced with the demographic challenge of an ageing population and the impending retirement of the 'baby boom' generation has to choose between four options (or some combination of them). Either:

- pensioners will become poorer relative to the rest of society;
- taxes/National Insurance Contributions devoted to pensions must rise;
- savings must rise; or
- average retirement ages must rise.

The Commission found the first of these options unattractive given the UK's already internationally low level of pensions, but that there were significant barriers to solving the problem through any one of the other three options alone. Section 4 discusses public views of this fundamental choice.

The current pension reforms

The Commission's main report in November 2005 proposed a series of reforms to achieve a mixture of the latter three responses:

- introduction of a low-cost, funded, National Pension Savings Scheme (NPSS), with employees automatically enrolled into this or good quality existing employer schemes. People would have the right both to opt out and to make additional contributions above the automatic minimum;
- this should be under-pinned by a less means-tested, more universal, flat-rate state pension than would result from unchanged policies. The cost of this, in the face of the demographic challenge, implied facing the reality of the need for *both* public spending on pensions as a share of national income *and* state pension ages to rise in the long run;
- as a corollary of the last point, and indeed of increasing life expectancy, a series of measures was needed to facilitate later and more flexible retirement.

The first of these, the NPSS, was designed to put right a market failure: the problems of a competitive system where individual pension policies are sold to potential buyers. To provide low-cost savings and high coverage, we suggested using the 'soft compulsion' of automatic enrolment to harness the power of inertia in a positive direction, the evidence being that participation in ‘opt out’ schemes of this kind is much higher than in ‘opt in’ schemes. At the same time, a national system would remove many of the costs of current provision for those outside large occupational schemes. Default *minimum* contributions to the NPSS would be set at about 8 per cent of earnings between the tax threshold and an upper limit:

- 4 per cent from the employee’s net pay;
- 1 per cent from tax relief (if they are basic rate taxpayers); and
- a 3 per cent compulsory employer matching contribution.

Additional contributions would be allowed (up to twice this amount for a median earner), contributions would be collected through the PAYE system or a newly created Pension Payment System, and funds would be invested on individuals’ instructions (generally in funds bulk-bought at low cost, including a ‘default scheme’ for those who did not make an explicit choice). We did not propose an general reform of tax relief for pension contributions, but suggested that the government should examine the case for a specific regime for the NPSS, giving a single rate of up-front matching payments (instead of tax relief on contributions and tax-free lump sums on retirement).

The state system proposals had five elements:

- building on recent reforms, by accelerating the evolution of the State Second Pension to become flat-rate, with improved carer credits;

- indexing the Basic State Pension to average earnings growth over the long term (preferably from 2010), and moving *accruals* of future rights onto a universal, individual basis;
- maintaining the recent progress which had been made in reducing pensioner poverty through the improved generosity of Pension Credit, but limiting the future spread of means-testing (by freezing the real value of maximum Savings Credit);
- accepting that this kind of structure required increases in both the State Pension Age and the level of public spending as a share of GDP in the long-run, with a trade-off between the two. We suggested a 'range for debate' in which, given current life expectancy projections, the State Pension Age (SPA) would rise from 65 in 2020 to between 67 and 69 in 2050, with public spending on pensions and other benefits to pensioners rising from about 6.2 per cent of GDP today to between 7.5 and 8.0 per cent of GDP depending on by how much SPA rose;
- 'ideally' paying the full Basic State Pension to all those aged over 75 on an individual basis.

In the light of the continuing wide differences in life expectancies by social class, we suggested that such reforms should be accompanied by an agenda that facilitated later working and gradual, rather than sudden, moves into retirement. This could involve: a focus on occupational health *earlier* in working lives and on the education and training of older workers; allowing earlier claim of Guarantee Credit than the SPA (for instance, this could stay at 65 as the SPA rose above it); removing the default retirement age of 65 currently allowed by anti-age discrimination legislation; improving knowledge of the advantages of deferring state pensions (then paid at a higher level) and allowing people to claim part of their state pension while deferring the rest of it, supporting, for instance, a transitional move into part-time work; and incentives for employers to hire post-SPA workers (such as reduced employer NICs).

The Government's initial response was mixed. While the Prime Minister, Tony Blair, and the Secretary of State for Work and Pensions, John Hutton, welcomed the architecture of the proposals as "basically right", newspaper reports suggested that the Treasury had major reservations about the potential cost of the state sector reforms. This was not so much the cost in the long run – the Commission's projections of long-run public spending of between 7.5-8 per cent of GDP were little higher than the Treasury's own projections of spending under current arrangements (*if* the minimum given by the Guarantee Credit continued to be linked to earnings, although there was then no commitment to this). Rather, the problem was in the 2010s. Without reform, spending on pensioner benefits was expected to *fall* as a share of GDP between 2010 and 2020, as the effects of the already-planned increase in women's SPA to 65 worked through. Under the Commission's proposals, spending would remain much the same share of GDP over this early period.

A six month period of consultation followed, not just with representative and expert bodies – most of which, whatever their views on particular details, backed the proposals – but also through a major 'deliberative polling' exercise in March 2006, National Pensions Day, organised by Opinion Leader Research (OLR) for the Department for Work and Pensions. Results from this are discussed below. At the end of this, in May 2006, the Government produced its first White Paper (DWP, 2006a). This accepted the Commission's main recommendations, and promised legislation, in the form of a Pensions Bill in the 2006-07 parliamentary session. Key elements of this, and variations from the Commission's recommendations, were:

- establishment by 2012 of a system of 'personal accounts', into which people would be automatically enrolled, but with the question left open as to whether these would be run along the lines of the Commission's NPSS or through an industry-based competitive model. Contribution rates would be as outlined above. In its second White Paper (DWP, 2006b), it proposed that personal accounts should be run largely along the lines of the Commission's proposed NPSS;
- a return to earnings-indexation of the Basic State Pension from 2012, 'subject to affordability and the fiscal position … but in any case by the end of the [next] Parliament'. The Guarantee Credit would be assumed to be earnings-linked as well, and the State Second Pension and Savings Credit reformed much as proposed by the Commission;
- State Pension Age would rise in three steps, to 66 between 2024 and 2026, 67 by 2036 and 68 by 2046, towards the top of the range suggested by the Commission;
- instead of the move towards residence-based accruals of rights to the basic pension, the existing contributory system would stay, but with

the number of years of contributions or credits required for a full payment reduced to 30 from April 2010 (see section 5).

The White Paper said little new about ways in which extended working lives and more flexible retirement could be supported.

Crucially for its potential long-term viability, this package attracted all-party support,[6] including for what might previously have been seen as controversial elements, such as the increase in SPA and compulsory employer matching contributions to personal accounts (if employees do not opt out). Criticism has mainly centred on the vagueness around the date for the return to earnings-indexation of the basic pension, and on whether the reforms will take enough people out of means-testing (Pensions Policy Institute, 2007).

The public and pensions: Great (but short) expectations

Ultimately, policy-makers have to yield to public preferences, unless they can change them. A problem for pensions policy is that levels of understanding are so low and have, if anything, deteriorated in recent years. Table 11.1 shows that the proportion of the population claiming even a 'reasonable, basic knowledge' of pensions fell from 53 per cent in 2000 to 47 per cent in 2005. At the same time, the proportion who had given 'a lot of thought' to arrangements for income in retirement had fallen from 35 to 26 per cent, and the proportion thinking that it was mainly their own or their family's responsibility to ensure people have enough money to live on in retirement had fallen from 50 to 37 per cent. More than half now lay the last responsibility at government's door.

[Table 11.1 about here]

Some of the attitudinal evidence collected for the Commission suggests that people are not so much trapped in the headlights, as wilfully shutting their eyes to the on-coming problem. Just over half, 52 per cent, agreed with the statement that, "I'd rather make sure that I had a good standard of living today than put aside money for my retirement", with only 42 per cent disagreeing (PC, 2005, appendix figure D.10). At the same time, when asked what income level they were aiming at in retirement, 19 per cent wanted "plenty of money to afford food, housing, living expenses and luxuries" and a further 38 per cent "enough to afford basic food, housing, and living expenses and to treat themselves about every week". Two-thirds of those with a private pension, but even just over half of those with *no* pension had one or other of these aspirations. Only 12 per cent of the population saw their aim as being no more than "enough to afford basic food, housing, and living expenses". Remarkably, nearly half of those who said they aimed at "plenty of money to afford food, housing, living expenses and luxuries" also said that they would rather have a good standard of living today than save for retirement (PC, 2005, appendix figures D.20 and D.21).

How much people thought such standards of living would need by way of income in retirement varied widely. The median response when people were asked what would be the 'minimum' net income in retirement, if they retired today, was £210 per week; the median amount needed for a ‘comfortable’ net income was about £310 per week. The answers people gave to such questions varied with income level, but by no means in proportion: comparing those with high incomes in a range about three times as high as those in a low income range, median responses to the ‘minimum’ income question rose from about £190 to £240 per week, and those for a ‘comfortable’ income from £260 to £350 per week (PC, 2005, appendix figures D.23 and D.25).

The answers were, however, very varied around these median figures. Part of this may reflect the difficulty for those far from retirement to think about such questions. But part reflects genuinely varied preferences. This – combined with widely varying situations in terms of other assets, accrued pension rights, expectations of inheritance, and so on – was one of the reasons why the Pensions Commission did not favour a move to a system of full compulsion designed to ensure, for instance, that everyone retired with a retirement income equal to two-thirds of their pre-retirement gross income. Instead, the proposals were designed to produce for someone with median earnings, a replacement rate of around 30 per cent from state pensions, a further 15-18 per cent from the NPSS, and the potential for voluntary NPSS contributions that would double this, taking the total replacement rate to 60-66 per cent. Even this would be well below the aspirations of many. In 2005 earnings terms, this system corresponds to gross incomes of around £195 per week for those with a fairly full working history making the default level of contributions to the NPSS, up to £285 per week for those making the maximum voluntary additions. The former is a little below the median view of a ‘minimum’ income in retirement; the latter is just short of the median view of a 'comfortable' income.

When retirement savings were discussed with focus groups convened for the Commission, people recognised that they were not saving enough for retirement, but opposed compulsion, even though they felt that encouraging people to save more without compulsion would not overcome barriers to saving. As we suggested, "there did appear to be some contradiction between participants wanting to make their own decisions, but also wanting to be told to do because they did not always feel they could make the right decisions" (PC, 2005, appendix D, p.108). The approach of 'soft compulsion' though automatic enrolment with the right to opt out may be the best way of coping with such conflicting feelings. Indeed, when the options were explained in the much larger deliberative polling exercise with more than 1,000 participants on National Pensions Day, 72 per cent favoured the idea of automatic enrolment with the choice to opt out, 20 per cent full compulsion with no right to opt out, and only 8 per cent leaving things as they are on a voluntary basis (OLR, 2006, chart 13).

One of the problems in designing – and selling – such policies is that people's expectations of their own longevity have lagged behind the views of actuaries and demographers. As Table 11.2 shows, the Commission's surveys confirmed other research (O'Brien, Fenn and Diacon, 2005) suggesting that younger cohorts simply do not anticipate the increase in their own life expectancy that actuaries now predict: people judge things by what happened to their grandparents and parents. The difference between people's expectations of how long their retirements might be combined with when they expect to retire generate anticipated life expectancies which are 3-4 years below the Government Actuary's most recent projections for survival beyond 65 those aged 56-65, but 6-9 years below them for those aged 26-35.

[Table 11.2 about here]

As a result it is hard to persuade people quite how expensive pensions are likely to be to provide, whether through funded or through tax-financed systems. Current best expectations are that men and women retiring today can look forward to spending a third of their adult lives in retirement (PC, 2005, figure 1.44). Funding one year in retirement for every two years of working age is a very expensive proposition, however you meet the costs. But if people's expectations are of a shorter retirement, voluntary retirement provision is likely to be inadequate, and systems that really do meet the cost will look very expensive to them.

Public opinion and the four unavoidable options

In the Commission's focus groups, participants were asked to award points between the 'four unavoidable options' in response to an ageing population described above. They were asked to do this both before and after detailed discussion of each option, its advantages and (more commonly) disadvantages. The amount of adjustment required for each option to solve the future problem by itself was set out. For instance, if all the adjustment were to be achieved through ‘poorer pensioners’ and none through the other three options, relative pensioner incomes would have to fall by 30 per cent. Alternatively, if it were all achieved only by later retirement, average retirement ages would have to rise from 63 to 70. As Table 11.3 shows, amongst the 70 participants involved in the groups, the detailed discussion changed the overall balance of opinion little. People favoured about half of the adjustment coming from saving more, most of the rest coming from higher taxes or working longer, and very little coming from pensioners becoming poorer.

[Table 11.3 about here]

This was a rather small group, of course. Parallel analysis of relevant questions asked in the 2004 British Social Attitudes survey by Phillips and Hancock (2005) came to similar conclusions. They found views that “effectively rule out public support for the suggestion that pensioners in future should have to live on less money”. But while there was partial support for better pensions paid for by higher taxation, “even among those who want extra money spent on pensions, there is no great appetite for more taxes”. They only found limited support for the suggestion that people should work longer and retire later, while although the suggestion that people should save more is popular *in principle*, many of those not doing so at present said they could not afford to do so. When asked unprompted (and before the Pensions Commission reports and associated intense media coverage around pension reform), there were,

> "various contradictions in people's views and behaviour which mean that we have not found clear support for any one of the propositions suggested by the Pensions Commission. It is, however, likely that some combination of more taxation, more private savings and later retirement will be necessary … But support is very tentative… if any future pensions policy is to square this circle, substantial changes in the public's attitudes and behaviour will be required." (Phillips and Hancock, 2005, p 189)

The National Pensions Day exercise explored whether people's views did change when the issues were explained in the way laid out by the Commission. Table 11.4 shows participants' views at the start and end of the day on five issues related to the four options. They are suggestive in terms of the need for a continuing active debate, particularly when thinking about the option of later retirement. Interestingly, opinion hardened during the day *against* the option of poorer pensioners, even with it being carefully spelt out that this was in relative terms, 'compared with the rest of society'. By the end of the day only one in six thought that this would have to be part of the solution. By contrast, support for both a higher share of taxes going to pensions and for people having to save more grew from over two-thirds to four-fifths or more. Most strikingly, at the start of the day, more people were against people having to work for longer than in favour. By the end of the discussions, 57 per cent were in favour and only a third against. At both the start and end, four-fifths thought that employers will have to contribute to employee pensions.

[Table 11.4 about here]

Table 11.5 shows that these preferences translated into a distribution of points (in this case from a total of 10) which was slightly more balanced between the three favoured options than in the earlier focus group exercise. Again, the idea of relatively poorer pensioners attracted very little support. A greater share of taxes and saving more attracted roughly equal support on average, and an increase in average retirement age about half as much. Opinion Leader Research also ran an on-line debate between February and March 2005 asking similar questions and with some of the same material available. Although, unlike the National Pensions Day participants, they did not form a nationally representative sample, the 5,000 participants gave a very similar balance of answers.

[Table 11.5 about here]

All this suggests that the basic strategy of a balance between greater public spending, greater savings, and later retirement, while avoiding the outcome of relatively poorer pensioners, is one that can command public support – but that support becomes firmer when people get the opportunity to debate the issues.

The (strange) survival of the contributory principle

In theory, the bulk of British state pensions spending is based on social insurance principles – entitlement depends on a 'contribution record'. As Beveridge put it in 1942:

> "Benefit in return for contributions, rather than free allowances from the State, is what the people of Britain desire … Payment of a substantial part of the cost of benefits as a contribution irrespective of the means of the contributor is the firm basis of a claim to benefit irrespective of means (1942, para 21).

Elaborate records are kept of how many years people have made – or have been 'credited' with – enough contributions, and entitlements depend on these.

However, over time this system has been eroded by governments of both Left and Right. From the Left, attempts have been made to correct the way in which those with interruptions to their paid work careers (particularly women with caring responsibilities) are excluded from a full entitlement through extending systems of credits for those in approved circumstances. For the Right, a non-means-tested system has always had the drawback that some spending will go on those who do not 'need' it, leading to policy changes that reduced the value of national insurance-based pensions against means-tested ones. The end result has been a system where benefits *mainly* depend on the fact of having made contributions, but people can receive 'contributory' benefits without having made contributions, and can be ruled out of entitlement despite having made contributions (Hills, 2004).

It is easy to mock the end result, and one of the important currents in the recent pensions debate has been whether this ill-understood and complex system should be swept away and the present basic and second state pensions replaced with a single 'Citizens Pension', a flat rate pension with entitlement depending only on a minimum number of years of recent residence in the UK. Despite the important arguments in its favour, the Pensions Commission rejected this approach, although we did recommend moves essentially in that direction. We suggested that:

- future *accruals* of rights to the *basic* pension should move onto a residence basis;
- *payment* of a full basic pension should 'ideally' be made automatically to those over 75, in particular to improve rights to a full pension for women with incomplete records;

- the state *second* pension should be retained, but over time become flat rate (more quickly than under current arrangements), with a wider group of carers credited into entitlement to it.

A major consideration in putting forward this kind of half-way house was the treatment of accrued rights. Governments avoid explicitly reneging on accrued pension rights,[7] and it seems unlikely that any would simply tell those receiving or expecting, say, large state second pension payments (reflecting past earnings), that they would now get a much lower flat rate pension. But if such accrued rights were respected (even if future accrual of S2P stopped) and the basic pension replaced with a simple more generous Citizens Pension, the better-off would be large gainers (and some with low incomes would not gain as a result of loss of means-tested benefits). To moderate (but not eliminate) the distributional consequences of this (and its significant immediate cost), one can imagine a system of 'offsets', under which those with existing entitlements above the new Citizens Pension would have no increase in receipts. But where we start from is complex. Some people have low S2P entitlements because they 'contracted out' of entitlement in return for paying lower National Insurance Contributions. It would be unfair if they were treated as generously as those who had the same incomes, but had paid in more. Again, one can imagine systems that deal with this. However, as one adds to the list self-employed people (who have also paid much lower NICs), women who chose to pay reduced contributions, those who have deliberately paid extra voluntary contributions to 'buy back' lost years, and so on, not only does complexity grow, but so do the potential difficulties of explaining why some people's bygones are bygones, but others are not and so will be 'offset'.

A second issue is the length of residence period that should count. New Zealand runs a Citizens Pension system based on just a few years of residence. But within the European Union, with transferability of state pension rights, setting, say, 10 years as the minimum could lead to workers who move around the Union being entitled to a full UK pension, as well as having fairly full entitlements to state pensions elsewhere. But if the criterion is longer residence – say 30 or 40 years – it becomes impossible to apply the rule retrospectively: we simply do not know who was resident in the UK for how long over such periods looking backwards.

Such problems – as well as a judgement about the ability of different reforms to gather widespread support – led to the Commission's proposals. But in this area, the Government is taking a somewhat different approach. It rejected the ideas of basing future accruals to the basic pension on residence or of automatic payment of the full amount at 75. Instead, from April 2010, the number of years needed for full entitlement to the basic pension will fall to 30, and a wider group of carers will accrue credits towards the second pension. These proposals hold on more to the idea of a 'contributory pension' more closely than the Commission – under what Ministers have called the 'something for something' principle – although their ultimate effects on entitlements are not so different. The much battered 'contributory principle' lives on.

Part of the reason for this is its apparently enduring popularity with the public, and the resonance of the idea of 'something for something'. On the other hand the 'something' for which one gets something, is not simply paid work, as can be seen from the National Pensions Day results summarised in Table 11.6. First, after discussion of the issues involved, participants were in favour of the idea that any "years spent living in the UK" should count towards entitlement to a basic pension. Exactly half agreed or strongly agreed with this residence-based principle, but a substantial minority, 35 per cent, disagreed.

[Table 11.6 about here]

In discussion, participants articulated precisely the key arguments for and against the residency principle (OLR, 2006, pp.31-33):

> "I agree with residency. I feel it is fairer. How much you get is proportional to how long you live here … everyone has a right to a pension."
>
> "Women, parents and carers would benefit and get a better deal".

But on the other hand:

> "… [it] would be unfair if people who had never worked got the same as someone who works all their life"

> "You could sit in the house for 40 years. … Why should we work when someone else gets the same who doesn't do anything. It's not fair. Pensions should be a reward for working."
>
> "I don't believe that the Government would be able to keep track of who is here. I would feel like there would be a big brother state if we kept track."

The lower half of the table shows people's responses when they had discussed various categories of people who should accrue entitlement to an additional pension in excess of the basic pension (effectively the state second pension, but very few people recognise the term). What leaps from the table is how long the list is, and how strong the support for some categories. 91 per cent think that paid work should lead to additional entitlement, but *more* think the same for caring for the sick, elderly or disabled, and more than 70 per cent think so for those caring for children, for those who are sick or disabled themselves and for those doing voluntary work. Only the unemployed miss out, although even here, as many think they should get the additional pension, 39 per cent, as disagree. When one thinks of the proportions of the population covered by one or other of these categories, this is getting close to 'all must have prizes', with rather few exceptions – those 'sitting in the house for 40 years', and so on. Less pejoratively, one could interpret this as a desire for a 'participation pension' reflecting Tony Atkinson's (1995) ideas of a wider basis than paid work for entitlement to a basic income, but stopping short of universal entitlement.

One interpretation is that the public would support the mix proposed by the Commission: a residence basis for a basic pension, but with an additional entitlement for a widened range of other activities. The support for the residence principle is, however, both narrow and limited to a basic component. It is certainly hard to see strong support for a simple integrated Citizens Pension in such results. And the Government's judgement (supported by the Conservative opposition) is that the idea of extra for 'deserving' groups and thus 'something for something' justifies retention of a modified contributory basis whatever the critiques that it amounts to a complicated way of ruling out a very small number from full entitlement.

Conclusion: Making decisions for the long-term

One of the desirable features of a pension system is that it should be stable. People need to know what the rules of the game will be in the future when they are making decisions about how much to save or when to retire, and they will be very unhappy if such rules are changed after they make those decisions. But the UK pensions system has been anything but stable in recent years. For current reforms to endure in a way that can rebuild confidence in pension saving, they have to be built on a consensus that will outlast one particular government. For that to be true, they have to command public support now, and that support has to last.

One of the encouraging features of the public consultations is that when the problems are explained to people, they do come to clear and generally consistent conclusions about the best ways forward. Around a thousand people took part in National Pensions Day debate, many reacting – perhaps to their own surprise – with enthusiasm to the idea of spending a day discussing pensions. It is hardly practical for such an exercise to be repeated for the entire electorate, but if current reforms are to stick, politicians will have to find some way of reminding the electorate what has been decided on pension reform and why. Ironically, the *lack* of controversy around the reforms may be a problem here. In early 2007, the Pensions Bill, containing what would previously have been seen as dramatic proposals such as raising State Pension Age, was proceeding through Parliament with very little media coverage, reflecting the all-party support for its key elements. At some point, its contents will start to affect people's lives: the reasons for the reforms may then need to be explained all over again.

Thinking about future pressures on social spending it is hard to avoid clichés about the need to make hard choices, and this is particularly the case with pensions policy. We simply cannot have it all, in the way suggested by some attitudes towards what people want by way of a pension but are expecting to pay through tax or pension contributions. Steering a way through this involves some politically tricky compromises. What is essential for those decisions to endure is that we make them with our eyes open. This requires careful analysis and explanation. Here social policy research and analysis – exemplified by Howard Glennerster's own continuing work (long after the State Pension Age now proposed for 2046) – has a significant role to play.

Notes

[1] See, for instance, the 'Epilogue' to Pemberton, Thane and Whiteside (2006).

[2] Albeit at a much less generous level than was needed to avoid reliance on the national safety net minimum, then known as National Assistance (Glennerster and Evans, 1994).

[3] If one allows for the proportion of 'private pensions' that are in fact either paid to public sector workers, the value of tax concessions, and the way in which part of private pensions represents private funding of compulsory pension contributions (under 'contracting out'), the truly private part of the system was, and remains, far smaller than 40 per cent of the total.

[4] But even this would have been true only at the point of retirement, and for those with relatively full contribution histories (Rake, Falkingham and Evans, 1999).

[5] Even this was already a substantial downward revision from earlier figures.

[6] See the House of Commons debate on 27 June 2006 and the report of the House of Common Work and Pensions Committee (2006).

[7] Although changes to indexation rules from those previously expected can be argued to have this effect, albeit less visibly.

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Tables and Figures

Tables

Table 11.1: Knowledge and views of pensions issues (%)

	2000	**2005**
(a) Self reported knowledge		
Good knowledge	13	12
Reasonable, basic knowledge	40	35
Knowledge is patchy	28	31
Know little or nothing	18	20
Don't know	1	2
(b) Thought given to arrangements for income in retirement		
A lot of thought	35	26
Some thought	36	36
Very little thought	17	23
Not thought about it at all	12	15
(c) Whose responsibility for ensuring people have enough money to live on in retirement?		
Mainly the government	42	55
Mainly a person's employer	4	4
Mainly a person themselves and their family	50	37
Don't know/No opinion/None of these	4	3

Source: PC (2005), Appendix figures D6-D8 (based on 1304 responses in 2000 and 855-875 responses in 2005).

Table 11.2: Differences between average derived estimates of life expectancy and GAD forecasts by current age (years)

Age	**Men**	**Women**
16-25	7.4	10.3
26-35	6.2	8.7
36-45	4.5	6.6
46-55	4.0	7.1
56-65	3.4	4.1

Source: Pensions Commission (2005); Appendix figure D6, based on 2005 Omnibus Survey and GAD 2004-based estimates of life expectancy.

Table 11.3: Focus group allocation of points between the four options (average points out of 20)

	Pre-discussion	**Post-discussion**
Having to pay into a pension or other savings	10	10
Increasing taxes/National Insurance	5	6
Work longer	3	3
Poorer pensioners	2	1

Source: Pensions Commission (2005), Appendix figure D4 (based on responses from 70 participants).

Table 11.4: National Pensions Day views of potential solutions to the pensions issue in the UK (%)

	Pre-debate		**Post-debate**	
	Agree/ strongly agree	**Disagree/ strongly disagree**	**Agree/ strongly agree**	**Disagree/ strongly disagree**
Pensioners will have to get poorer compared with the rest of society	24	59	16	78
A greater share of taxes will have to be spent on pensions	68	15	80	11
People will have to save more for their retirement	70	19	88	7
People will have to work for longer	42	45	57	33
Employers will have to contribute to employee pensions	81	8	84	7

Source: OLR (2006), charts 3-7.

Table 11.5: Support for the four options (average points out of 10)

	National Pensions Day	**On-line debate**
Pensioners becoming poorer compared to rest of society	0.4	0.7
Greater share of taxes spent on pensions	4.1	4.0
Saving more	3.6	4.2
Increase in average retirement age	2.1	2.2

Source: OLR (2006), charts 16 and 37.

Table 11.6: National Pensions Day views of what years should count towards state pension entitlement

	Strongly agree	**Agree**	**Neither**	**Disagree**	**Strongly disagree**	**Don't know**
Towards the basic state pension						
Years spent living in the UK	21	29	12	21	14	2
Towards the additional state pension						
Caring for sick, elderly or disabled	49	45	3	2	1	-
Paid work	53	38	4	3	1	1
Caring for children	40	44	7	7	2	-
Long-term sick or disabled	20	53	9	7	1	-
Voluntary work	20	51	15	12	2	-
Unemployed but actively Seeking work	7	32	21	25	14	1

Source: OLR (2006), charts 8-10.