Pensions for the masses: Automatic enrolment should lead to a significant boost in pension coverage amongst private sector employees

***Rowena Crawford**, **Carl Emmerson** and **Gemma Tetlow** of the Institute for Fiscal Studies (IFS) examine the reform to workplace pensions. While automatic enrolment will mean greater pension coverage among private sector employees, they argue that the effect on total saving in the economy is ambiguous.*

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On Monday, a very radical reform of workplace pensions in the UK will start to be rolled out across the country. The majority of employees who work for large private sector companies will – for the first time – find themselves enrolled automatically into an employer-sponsored pension scheme; for some of these people it will be the first time that their employer has offered to make a contribution to any pension scheme – a minimum of 3% of gross salary (within a band), provided the employee contributes at least 4%. Employees have the choice to opt out subsequently, but those doing so will risk losing the contribution from their employer. Ultimately, most employees aged between 22 and the State Pension Age will come within the scope of this policy, but it will take some time – these new rules will not cover all employers until February 2018. A new, state-owned pension provider – the National Employment Savings Trust (NEST) – has been established to ensure that all employers can provide their employees with access to a relatively low-cost pension scheme.

Automatically enrolling employees into a pension scheme is likely to have a significant impact on the number of private sector employees who contribute to a pension. In 2011, just one-in-three private sector employees were members of a workplace provided pension scheme (compared to over four-in-five public sector employees). An increase in pension coverage is likely for two reasons. First, evidence suggests that when employees are defaulted into a pension more will remain a member of that scheme than would have made an active decision to join a scheme. Second, many private sector employees will find themselves able to receive a pension contribution from their employer for the first time, which will make pension saving financially more attractive. The low level of coverage among private sector employees pre-reform gives plenty of scope for a significant increase in pension coverage.

While there are good reasons to expect pension coverage to increase, the impact on overall saving is less clear. This is for a number of reasons. First, evidence suggests that defaulting employees into pensions leads to more individuals choosing to contribute the default amount, perhaps because individuals decide not to bother reviewing this level of contribution in the belief that the default amount has, in some sense, been recommended. While this would lead to an increase in pension saving among those who would not otherwise have saved in a private pension, it would lead to a reduction in saving among those who would otherwise have chosen to save more than the default amount.

Second, if individuals do increase their pension saving as a result of this reform, this does not necessarily mean that overall saving will rise. An increase in pension saving could be funded by a reduction in the amounts households save in other forms or, arguably even worse, by some running down their debts less quickly than they would have done. Third, the cost of increased employer contributions (and any additional costs to businesses of administering new systems) will need to be financed from a combination of lower wages, higher prices or lower profits; all of these could depress saving.

Although the impact on total saving in the economy is ambiguous, automatic enrolment should nonetheless lead to a significant boost in pension coverage among private sector employees, and those who have good reasons for not saving in a pension at the present time remain free to opt out if they wish. Current economic conditions may lead to opt out rates being higher than was anticipated when this policy was first suggested by Adair, now Lord, Turner in 2006. Evidence on the actual impact of automatic enrolment – on pension coverage, pension saving, overall saving, and levels of earnings – should be gathered in order to help inform future decisions over the precise policy design. However, a challenge for anyone hoping to answer these questions is that the reform is being implemented in a way that will make robust estimation of its impact difficult; careful consideration of data will be needed to shed light on precisely what effect automatic enrolment is having. Simply getting more people to save in a pension will not achieve the Government's overall objectives if it is also accompanied by a reduction in the amounts saved into pensions or saved in other forms.

There are a number of features of both automatic enrolment and the establishment of NEST that will need to be monitored closely and perhaps reformed once the initial impact of the policy changes has been seen. On automatic enrolment, two key decisions will be whether the default minimum contribution rates should be changed, and whether administrative burdens on employers (which have been of particular concern to small businesses) could be further eased without inducing other negative consequences. As far as NEST is concerned, a key decision to be made is whether any of the additional regulatory restrictions on NEST (such as annual contribution limits and restrictions on transferring existing funds in), which do not apply to other pension providers, should be lifted. Ideally, in the longer-term there would be open competition between pension providers, with NEST being neither advantaged nor disadvantaged relative to other market players.

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