Britain: Shock for millions of workers who rely on private pensions

Jean Shaoul
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A staggering 50 percent of workers that depend on a secure occupational pension to bolster the meagre state pension have seen the safety net pulled from under them. Recent developments have removed the central prop of successive British governments' pension policy—reliance on private pension plans—and threaten a social catastrophe. As a result millions of workers face destitution in the last years of their lives.

A recent report from William M. Mercer, the employee benefits consultancy, has revealed that many of UK quoted companies do not have sufficient funds in their corporate pension funds to ensure that their employees will get the retirement incomes they were promised. ICI has disclosed a £453 million shortfall in its £7.6 billion pension and healthcare schemes. Other companies' pension funds that are also in the red include Allied Domecq, Carlton Communications, Compass and Granada. It estimates that 52 percent of companies will see a fall in the value of their pension funds' assets at the end of 2001, compared with 28 percent the previous year.

Only last August, actuaries Bacon & Woodrow were reporting that 17 of Britain's 100 largest companies have pension schemes that are seriously under funded, up from 10 in 2001.

Further confirmation of this comes from official government statistics that show that total assets held in occupational pension funds, both public and private sector, had fallen to £679 billion in 1999, a drop of £105 billion reported by National Statistics only three months earlier. They also calculate a further fall to £658 billion in 2000.

This bombshell follows the introduction of the new FRS17 accounting standard, designed to show the true cost of a company's pension fund obligations. Pension fund assets, typically invested on the world's capital markets in shares and bonds, must henceforth be reported at market price, while liabilities must be discounted by the yield on corporate bonds. Any shortfall in the ability of the pension fund's assets to cover its liabilities must be reflected as a liability on the company's own balance sheet. As a result of the falling stock market, FRS17 (which does not come into full force until 2003) and the low value of their pension funds, more than half of UK companies will see a fall in the value of their assets.

In a bid to avoid cutting dividends, companies are moving to abandon or alter their final salary schemes in favour of money purchase schemes. Final salary pensions—whereby a worker's retirement income is guaranteed according to years of service and final salary irrespective of the economic conditions—provide a better pension since the employer must make up any shortfall between the guaranteed income and the value of the contributions needed.

Now many of Britain's top companies, including Marks & Spencer, British Telecom, Lloyds Bank, TSB, Sainsbury's and Barclays Bank, are cutting costs and abandoning their final salary schemes. They are putting all their new employees on money purchase schemes that offer no guarantees and provide pensions that depend upon the amount paid in, the stock market and interest rates.

Others, such as Tesco, the supermarket chain, have repudiated their obligations to their existing workforce and are proposing to offer pensions based on average salary not final salary. The accounting firm Ernst & Young and food giant Iceland have gone one step further and closed down their guaranteed final salary pension schemes, transferring their employees to defined contributions pensions that depend upon the level of contribution. Many more are expected to follow suit.

Even before this latest blow to workers' pension plans, several million workers who rely on their employer's money purchase schemes were set to receive retirement incomes less than half what they were expecting. This is due to falling stock markets, low interest rates, increased life expectancy and the removal of an annual £3 billion worth of dividend tax relief for pension funds by Chancellor Gordon Brown in his first budget.

Another report from William M. Mercer showed that a 30-year-old man who joined a money purchase scheme in 1991 and put in a total of 10 percent of his salary could have expected a pension equivalent to 55 percent of his final pay when 65. In comparison, someone joining today could expect to retire with a pension of just 24 percent of final pay for the same level of contributions or double their contribution to 20 percent of salary. They did not of course point out that few were likely to remain in well paid jobs long enough to build up the necessary contributions as a result of successive rounds of corporate downsizing.

A survey by the National Association of Pension Funds (NAPF) of more than 800 company pension funds with combined assets of £410 billion found that 46 companies have ditched their final salary schemes to new employees in the past year, compared to 18 the year before. The number of people in final salary schemes has fallen by nearly two million in the last decade.

According to NAPF, switching to money purchase schemes

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disadvantages employees twice over: they end up taking on the investment risk from their employers who also slash their contributions by one third when they switch into a money purchase scheme.

What few commentators seem to have noticed is that many of these companies, Britain's finest, had taken a pension 'holiday' from making contributions to the pension funds during the boom years. In this way they stripped out more than £11 billion from the pension funds at the expense of their workers. The privatised state owned industries such as British Telecom had inherited pension funds with massive pension surpluses as an additional perk.

Neither have any of the highly paid financial analysts seen fit to point out that the much vaunted profits growth in the 1990s depended upon the downright theft of their employees' deferred income. Nor have they drawn any conclusions about the flaky character of these companies' performance during the boom years.

In some cases, the size of the employers' contribution has been peanuts. Iceland let the cat out of the bag when it said that it had to increase its contributions from a mere £4 million to £14 million to make good the shortfall. It had inherited the Booker scheme, when the two companies merged last year, which had taken a six-year pension holiday.

The shift to money purchase pensions also has implications for the capital markets. Companies, free from the obligation to deliver a defined level of benefits, are only required to offer inflation protection of up to five percent a year. They can do this by switching from investment in shares to bonds that offer a defined yield for a lower level of risk, compared with the uncertain yield of shares. Boots, the high street chain of chemists, was the first to announce that it was pulling out of equities and into bonds, despite having a well-funded pension scheme. It is widely expected that others will follow suit, further exacerbating the stock market's slide and increasing the attractiveness of corporate bonds.

According to a recent study by *Labour Research*, at the same time as the big corporations are cutting pensions for their staff they plan massive pensions for their directors. Rentokil, the giant facilities management company that employs hundreds of thousands of workers on minimum wages, announced last February that it is to axe its final salary pension scheme, but its CEO, Sir Clive Thompson, a vociferous opponent of the minimum wage, will retire on at least £562,000 a year. At Sainsbury's, where the final salary scheme has been closed to new staff, the chief executive will get £351,000 a year. Tesco's boss will get £309,000 a year. Even this fails to take into account the fact that many directors go on to take well paid sinecures when they retire. A non-executive director may be asked to work for 12 days a year and for that period are paid twice the average annual wage.

More than 250,000 directors of Britain's top companies have secured themselves pensions worth more than £100,000. The biggest pension goes to Jean-Pierre Garnier of the pharmaceutical giant, GlaxoSmithKline, who will receive a massive £833,000 a year, more than 220 times the current state pension retirement pension.

It is not just Britain's bosses who look after themselves at the expense of their staff, so do Britain's legislators. At the same time as MPs ignore the plight of workers who face a catastrophic fall in their pensions, they are demanding a huge increase in their pensions at the taxpayers' expense. Last summer MPs voted by 215 to 172 for changes that would mean that they would be entitled to their maximum pension after 27 years' service, compared with the 40 years most pensioners face, reduced from the 33 years that MPs had been able to enjoy.

A recent report from PriceWaterhouseCoopers has said that the state pension can only rise to the level of the current minimum income guarantee and keep it in line with earnings if the retirement age were raised to 72. The Institute for Public Policy Research, the government's favourite think-tank, has also called for the raising of the retirement age, thereby increasing the funding available for the state pension via national insurance contributions.

Yet Britain has remarkably low taxes by European standards. The Institute of Fiscal Studies calculated that if Britain paid as much tax as Germany, spending on health and education could be doubled; while taxation at the French level would enable spending on social security to be doubled. Neither the proportion nor the number of elderly people is expected to increase very significantly in the coming period.

The average state pension in Europe is worth about half the average wage. In Britain however the state pension, at just £75 a week, is worth less than 20 percent of the average wage and is predicted to fall to less than 10 percent by 2050. Even with a means-tested benefit payment, the "guaranteed minimum income" that many pensioners do not know they are entitled to, pensioners do not have enough to live on.

Far from acknowledging the disastrous consequences of forcing people to rely on the private sector to provide a decent pension, the Labour government refuses to raise the basic state pension. It is adamant that people must save more for their retirement and has launched a 'stakeholder' pension, a private pension plan based upon money purchase and targeted at those with below average incomes.

Few have taken up the government's scheme. Although 250,000 stakeholder pensions have been taken out in the year since last April when the scheme began, most of them were transfers from existing pension schemes. Contrary to government expectations, only 50,000 new savers have taken out a stakeholder pension and few of them are believed to be from the targeted income group. This is hardly surprising since it is hard to keep one's head above water on a below average income in modern Britain and stakeholder pensions are widely acknowledged to be poor value for money.

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