Britain: Pension proposals do nothing to resolve retirement income crisis

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The Labour government chose the week before Christmas to release its long-awaited proposal on pensions, presumably because the seasonal festivities would mean people were too preoccupied to notice its dire content.

Rather than guaranteeing workers a comfortable pension on retirement, Labour's proposals mean an ageing workforce can now look forward to working up to five years longer and receiving a reduced pension payout from their employers.

The paper insists that, despite the problems, the largely voluntary system of private pension saving must be given one last chance. It proposes a radically simplified single tax regime for pensions; incentives to work longer and an information drive warning people that they are not saving enough.

The green paper also says that ministers plan to keep compulsion "under active review" in case the measures proposed do not work. This move comes despite work and pensions secretary, Andrew Smith, having apparently ruled out extra compulsion shortly before the paper was released, declaring it to be "not necessarily in everyone's interest"; a view shared by the Confederation of British Industry.

If the changes outlined in the green paper survive more or less intact, they could apply from as early as April 2004.

The government's proposals mainly favour employers and higher wage earners. Those able to afford it will have the freedom to pay in up to 100 percent of annual earnings (to a ceiling of £200,000 a year). Use of capital windfalls to fund pensions would be allowed as well as members of company pension schemes would be able to also pay into individual

On retirement, people would be able to work part-time and draw a pension. However, those retiring after 2010 will not be able to draw pension before the age of 55. Many public sector employees who join the workforce after 2006 would have to work to 65 to qualify for a full pension.

For the average worker, however, there is much bad news. Low earners will continue to miss out on means-tested state benefits if they hold a small private provision thus providing no incentives to enable them to save.

Nor is there any comfort for members of "final salary pension schemes", many of which are now being wound up by employers for being too costly.

Final salary schemes set retirement income as a percentage of an employee's pay. In contrast, defined contribution-style pension funds base retirement income on the level of contributions from employees and employers. A growing swathe of companies have been switching away from final salary schemes amid rising costs, increased longevity and sharp stock market falls which have eroded the assets of many pension funds.

A survey by the National Association of Pension Funds (NAPF), which represents about 1,000 schemes owning £700 billion of assets, has shown a sharp acceleration in the shift away from traditional final salary retirement schemes during 2002, which is increasing the pensions gap as savings usually drop when companies switch from final salary to defined contribution schemes.

Some 85 final salary schemes were closed to new entrants in 2002, the survey showed, nearly double the amount in 2001. The NAPF said 30 percent of the 477 private sector final salary schemes it surveyed were closed to new entrants, up sharply from 17 percent in 2001. Twenty-five of the 85 final salary schemes to close to new entrants in 2002 also closed to existing members.

The NAPF's survey showed that employer contributions to defined contribution schemes were much lower, falling on average from 6.4 percent of salaries in 2000 to 6.05 percent. In contrast, average employer contributions to final salary schemes had risen from 8.3 percent in 2000 to 10.45 percent in 2002. This means that employees are losing out twice: they and their employers are paying less into a scheme that will inherently pay less than the final salary scheme that has now been closed to so many.

The NAPF is calling for the national retirement age to rise from 65 to 70 by 2030.

One solution presented in the green paper is for existing final salary schemes to become less generous, allowing more flexibility in the benefits they provide as a means of cutting costs. For example, they could choose not to offer pension increases or widows' pensions.

It also proposes a cap on pension savings. The proposed rules would allow everyone to amass a fund of £1.4 million. The fund would be valued at retirement, and any excess would suffer a 60 percent tax charge—the 33 percent recovery charge plus income tax at 40 percent on the balance. Benefits built up from contributions made before the changeover would be valued and included in the £1.4 million total. Funds already £1.4 million or larger would be protected, and any excess at changeover would not be taxed. Although £1.4 million looks high, it is equivalent to a pension of around £65,000 a year, and because it would be linked to price inflation rather than earnings, it would gradually be eroded—to the equivalent of around £40,000 a year within 20 years.

The government has been strongly criticised since the green paper's release because of its inability to reach any new solution to avert an impending pensions crisis. The works and pensions secretary has been denounced on all sides for failing to grasp the scale of the "pensions crisis", with the green paper branded a "missed opportunity".

There are fears that the government's proposals may even exacerbate the country's pensions crisis by accelerating changes and closures to occupational schemes. For example, Peter Tompkins, vice-president of the Institute of Actuaries, says that proposals requiring companies to consult employees or employee representatives before changing company schemes are likely to lead to a rash of closures and other changes before such a requirement becomes law.

In the wake of decisions by shipping giant Maersk, Cardiff-based steel company ASW and others to wind up company pension schemes, the paper proposes consulting companies on ideas first put forward in March 2001 to protect employees when schemes are closed down. These include giving current contributors a big share of the wind-up pot, putting pension rights ahead of other creditors, either secured or unsecured, or some form of insurance for insolvent schemes. It also suggests more protection for workers when solvent companies wind up schemes.

But Tompkins said the green paper was "a step backwards from March 2001. The government has consulted on all this before and stepped back from it because many employers' organisations were opposed. They still are."

Although the government is anxious to resolve the pensions crisis, it is equally concerned it should not be at employers expense. Despite canvassing the ideas, the green paper says: "We need to strike a careful balance between the potential impact on business and the need to provide adequate protection for members." In addition, when it comes to further protection for members where a solvent company winds up, the paper says the government "will be guided by the aim of not increasing the overall burden on employers providing pensions".

But government efforts to cut the size of state pension provision by pushing workers into private schemes have fallen short of their targets. A multi-million pound advertising campaign to persuade people to take out the government's flagship stakeholder pension has failed.

Actuaries have also warned that employers may have to pump an extra £15 billion a year into pension funds if the UK is forced to implement a 20-year-old European directive protecting workers whose companies go bust.