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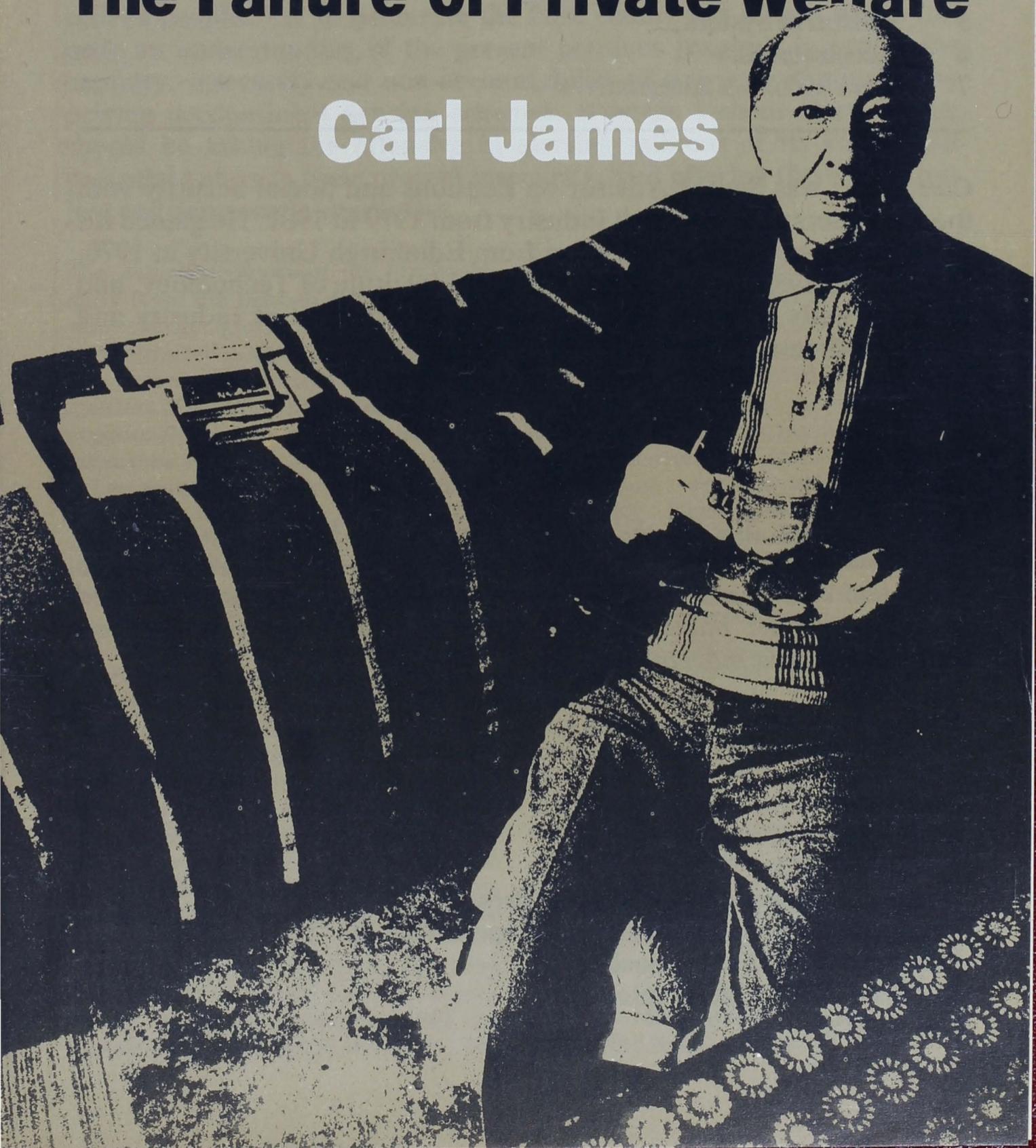
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# Occupational Pensions: The Failure of Private Welfare

Carl James



Fabian Tract 497

# Occupational Pensions: the Failure of Private Welfare

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# 1. Introduction

**A major Conservative onslaught on pensions is in preparation. Behind and beyond Norman Fowler's current inquiry lies a right-wing ideological offensive which seeks the further privatisation of the welfare of retired people. Yet to penetrate the false claims and jargon which impede an understanding of the present pensions jungle is to expose the inequity, insecurity and non-accountability of a system dominated by private occupational pension schemes. It is the Labour Party which should be taking the offensive in alerting millions of its voters and potential voters to their present insecurity, and offering them a secure, just and democratic alternative.**

The immediate focus of the Fowler inquiry is on the pension rights of people who change jobs. 'Portable pensions' have attracted a lot of favourable coverage, because each year around three quarters of a million people lose their occupational pension rights when they move jobs.

For anyone who has lost their future pension entitlement after several years of compulsory contributions to an employer's occupational scheme, the idea of an individual pension arrangement is an attractive concept. It has received favourable coverage even in some trade union journals (e.g. *Journalist*, March 1984).

However, the indications are that it is being used as a stalking horse for the privatisation of all earnings related pensions. The Centre for Policy Studies in its written evidence to the Government inquiry has called for legislation to prevent employees being forced to join pension schemes. It would also allow them to opt out of the State Earnings Related Pension Scheme.

Such a move would be in line with Government thinking on two counts. Firstly, the idea of personal financial responsibility is ideologically attractive. The

Centre for Policy Studies stresses the idea of individual ownership of pension rights.

Secondly, it would enable the Government to reduce its level of expenditure, by cutting current and future commitments to both the State Earnings Related Pension Scheme and the public sector occupational pension schemes. The Chancellor, Nigel Lawson, has given oblique support to this view last November when he talked of 'an adequate old age pension', beyond which people could make their own arrangements.

The state pension schemes currently cost the exchequer £16,300 million a year. This figure is set to rise by a third in the next thirteen years as the State Earnings Related Pension Scheme comes into full operation. This £5,000 million increase in expenditure is something the government wishes to avoid (David Lipsey, 'Can we afford a ripe old age', *Sunday Times*, 4 December 1983).

Public sector pensions involve payments of about a further £6,000 million a year. They have already beaten off one attack from the present Government. Early in Mrs Thatcher's first tenure of office, the Scott Committee, set up to

examine public sector pensions, bitterly disappointed her by rejecting plans to stop the indexation of public sector pensions to inflation. The cost of maintaining pension benefits in line with inflation has proved a major obstacle to the selling off of several enterprises.

The present review of pension provision will provide the Government with another bite at the cherry. No one should be in any doubt about the Government's intention to reduce pension benefits. It has been one of their most consistent themes. SERPS, public sector occupational pensions, and the flat rate National Insurance pension have all attracted the attentions of the present administration.

One of the earliest moves of this Government was to remove the link between the basic flat rate pension and wages. Before this change, pensions had been linked to the higher of wage or price rises. Since then, they have been linked to prices alone. Last year, the Government also changed the method of uprating state pensions in line with prices. For the previous seven years, the rise had been based on the Treasury forecast of inflation over the previous 12 months. The Government picked the month when historic in-

flation was lowest to implement this change, thus further reducing the expenditure on pensions.

While the Tory record on pensions is niggardly, it would be a mistake simply to defend the present position of mixed state and occupational, flat rate and earnings related pensions. The present arrangements have severe drawbacks, some of which have given the current private offensive its opportunity. The current arrangements are inefficient, inequitable, and – in the occupational sector particularly – provide little security of pensions and less accountability.

While the present system of occupational pensions leaves a great deal to be desired for the vast majority of people, and while the proposals being touted around by the Centre for Policy Studies and other right wing groups would address some of the current anomalies, they would create other, possibly worse ones. Personalised pensions can no more offer a secure income in retirement than occupational schemes can do for the mass of ordinary workers. It is the purpose of this pamphlet to expose the current situation and open up a debate on possible alternatives.

## 2. Pensions Today

Over 11 million employees are members of occupational pension schemes, about half the workforce. In 1982, they and their employers contributed over £14,000 million to occupational pension schemes, roughly 7 per cent of national income.

Some four million receive pensions from occupational schemes. About 40 per cent of all people over 65 receive an occupational pension. In 1982 total household income from occupational pensions and related benefits from life assurance and superannuation schemes was £14,313 million, over £120 million more than the amount paid out from the Exchequer in National Insurance and other social security pensions (*National Income and Expenditure*, 1983 edition, HMSO).

The size of the occupational pension fund sector can be gauged by the fact that in 1982 the total income of these funds exceeded all expenditure on health and education. They involve more people and more resources than any single sector of welfare provision. Only the entire National Insurance system is larger.

Occupational pensions clearly have a crucial role in pension provision in the United Kingdom. The 1975 Social Security Pensions Act regularised the relationship between state provision and occupational pensions. However, both state and occupational provisions are complex.

State provision consists of three elements:

- the basic flat rate state National Insurance pension, at £54.50 for a couple, paid to those who have the required National Insurance contributions.
- the State Earnings Related Pension Scheme (SERPS), which began to operate in 1978. SERPS aims to provide a pension related to the best 20 years earnings of any contributor. For the average earner in 1998 this should add a quarter of his or her final wage on to the basic state pension. For an individual this would then

represent about half his or her final earned income. For a couple with one wage earner, it would represent somewhat more. SERPS is slowly coming into operation, at the rate of 1¼ per cent of salary per year. Someone retiring in 1984 would have a SERPS entitlement of 7½ per cent of their average salary over the past six years.

– the means tested state supplementary benefit, payable to the 1.5 million poorest pensioners at the rate of £54.55 per week for a couple with housing costs on top.

Occupational provision is possibly even more complex. The Civil Service pension scheme is non contributory, but guarantees benefits on the basis of past service. Other public sector workers are members of contributory schemes which also provide benefits on top of the basic state pension.

However, these schemes are 'contracted out' of the state scheme and provide benefits in place of SERPS. Both employer's and employee's National Insurance contributions are accordingly reduced. Similarly there are a large number of private sector occupational pension schemes which are contracted out. These

**Glossary**

**PRESERVED or DEFERRED PENSION** – the right to a pension of a former contributor, who has withdrawn from the scheme, but not yet attained pensionable age.

**TRANSFERRED PENSION** – the right to a pension for which contributions have been transferred from a previous scheme.

**GUARANTEED MINIMUM PENSION** – the minimum pension right due to a member of an occupational scheme contracted out of the State Earnings Related Pension Scheme (SERPS, see chapter 2) under the 1975 Social Security Act, aiming at 25 per cent of earnings on top of the basic flat rate state National Insurance pension (see chapter 2).

**PORTABLE or PERSONAL PORTABLE PENSION** – a future pension derived from both

employee's and employer's contributions, but the personal property of the employee, who retains it for future enhancement on transferring to a different employer.

**CONTRIBUTORY PENSION SCHEME** – a scheme where both employee and employer make contributions.

**NON CONTRIBUTORY SCHEME** – a scheme where only the employer makes contributions.

**CONTRACTED OUT PENSION SCHEME** – a scheme contracted out of the State Earnings Related Pension Scheme and providing benefits instead of SERPS.

**CONTRACTED IN PENSION SCHEME** – a scheme contracted into SERPS and providing benefits additional to those provided by SERPS.

usually provide a pension which includes the basic state pension. There are also some private sector schemes which are 'contracted in' and provide benefits on top of SERPS.

Since 1978, occupational schemes contracted out have had to provide a guaranteed minimum pension (GMP) equivalent to 1¼ per cent of annual salary per year of service. They have also been subject to requirements to preserve and uprate the GMP in line with increases in earnings for those with over five years contributions.

The GMP is less generous than the SERPS ultimate pension which is based on the best 20 years earnings. However, occupational pensions aim to do better than this. They have tax concessions on contributions and on other income. Beyond the date of retirement the burden of inflation proofing GMPs in payment is the responsibility of the state. Pension funds are able to buy back that quarter of employees who stay less than five years in a job, with the payment of a 'contribution equivalent premium'. This is the sum of

the precise contributions which would have been due had the employee remained fully in the state scheme. The fund keeps any excess and any interest. They are also able to make arrangements which place some of the cost of revaluing preserved GMPs on the exchequer, when inflation goes above certain limits, currently 8½ per cent.

National Insurance contributions are levied between a lower and an upper earnings limit, from £34 to £250 per week. SERPS accumulates on income below the upper limit. With the state flat rate basic pension and earnings related pension up to an upper limit, income differentials after retirement are reduced. A worker on the upper limit would get only 44 per cent of final earnings, but a low paid worker could get two thirds of final earnings, when SERPS comes into full operation. Occupational schemes usually take a flat proportion of earnings from both employee and employer without an upper limit, and provide benefits that are proportional to the previous earnings. They do not aim to

reduce income differentials in retirement.

Schemes differ greatly in their structure, levels of contribution and benefit, control and most other ways. In the public sector there are unfunded schemes and 'notionally' funded schemes alongside the main funded type of scheme, which also dominates the private sector's pension arrangements.

75 per cent of public sector employees are members of pension funds, a total of 5,600,000 in 1979. At that time there were also 1,800,000 former employees receiving pensions and 500,000 dependants gaining benefit (*Occupational Pension Schemes 1979*, sixth survey by the Government's Actuary's Department, HMSO). Public sector funds cover local authorities and public corporations, and have total assets of over £44,000 million. They are run in much the same way as private schemes, but tend to have higher rates of contribution and more secure pensions.

However, the Civil Service has an unfunded pension scheme, which covers its 700,000 employees. This operates essentially in a pay-as-you-go manner, with the contributions matching the pensions paid out. It is also a non-contributory scheme with regard to its members. The employer pays all the contributions.

There also exists a peculiar pension scheme, primarily for teachers, which is 'notionally' funded. Teachers and their employers contribute to the scheme, which then pays these contributions straight out as pensions. This scheme is notionally funded for historic reasons. The funds are notionally invested in war bonds, and the contributions adjusted to take account of any notional surplus or deficit.

Private sector funds include only 40 per cent of employees in that sector, but this involved 6,200,000 members in 1979, more than in the public sector. There were, however, fewer pensioners, a total of 1,400,000 (including 200,000 depen-

dants of former members). But private sector schemes are now larger than public sector schemes, with over £60,000 million assets. While their assets have been larger than schemes in the public sector for some time, it is only in the last ten years that the number of members has exceeded those of public sector schemes.

## Legislation in the 1970s

The rapid expansion in the coverage and particularly the assets of pension funds and schemes has been in large part the result of the 1973 and 1975 legislation. This accelerated the growth of pension arrangements which had been developing for many years.

In the last year of the 1964-70 Wilson Government, Richard Crossman developed proposals for a pension system which was an attempt to bring Britain's pension arrangements up to the standards being set in Scandinavia and elsewhere in Europe. The general election of June 1970 torpedoed Crossman's plan.

His Conservative successor, Sir Keith Joseph, pushed through legislation in 1973, giving a predominant role in future pension provision to occupational pensions. The general election of February 1974 however stopped this plan getting off the ground. Barbara Castle revised the Joseph proposals in the Social Security Pensions Act of 1975. This Act set up a State Earnings Related Pension Scheme, but allowed occupational pensions a much larger part than was envisaged in the original Crossman proposals.

Funds were faced with a choice of operating on top of the state scheme, i.e. providing benefits in addition to the state earnings related pension, or of contracting out and providing pensions in place of the earnings related part of the state pension. After a vigorous campaign by the National Association of Pension Funds, backed by the CBI, over 80 per cent of funds decided to opt out.

### 3. Insecurity in Old Age

Pension funds have two main functions. They have to provide their retired members with an adequate income, and they have to assure current contributors that when they retire they too will have an adequate pension. Occupational pension schemes fail the majority of their members in both these respects. Because of restrictive arrangements for transfers, preservation of contributions, and minimum service periods, most current contributors will receive either no pension or a minimal pension from their current scheme. Current pensioners frequently face pensions of diminishing value.

#### Pensions and inflation

The great failure of private sector schemes is to match inflation. Only 50,000 out of 1,100,000 members of private sector schemes in 1979 who had been in receipt of pensions for 12 months or more saw their pensions rise to match even 75 per cent of inflation. 450,000 received no increases at all. Few private sector funds specify any obligation to meet inflation with pension rises. Only one pensioner in five is a member of such a scheme. Even then the obligation is only to match inflation up to three per cent.

The actual performance of funds is considerably better than the obligations they put down on paper. Half of the 80 per cent of schemes accepting no obligation

to increase pensions with inflation actually did so. Nevertheless, in 1979, nearly half a million occupational pensioners faced inflation of over 18 per cent with no increases in their income.

Even at today's 6 per cent inflation, the near half million pensioners receiving no increases at all would see their pensions decline by half in value in the ten years following retirement. They face increasing age and infirmity with their extra expenses and a perpetually declining income. Although most schemes did manage some increase, few even came close to matching inflation in the late 1970s.

It has been maintained that occupational pensions are now doing much better. They have lower inflation than ten years ago, and a more buoyant stock

#### *Pension increases promised and delivered amongst private sector schemes*

	Promised	Delivered
no increase	80%	40%
three per cent	20%	10%
half inflation		25%
two-thirds inflation		20%
over two-thirds inflation		5%

Source: *Occupational Pension Schemes 1979*, op.cit.

market, real positive interest rates and no problems about overseas investment. Recent evidence does not bear this proposition out. The most recent survey of the National Association of Pension Funds, March 1983, showed that few private sector occupational pensions were keeping up with inflation (NAPF, *Survey of Occupational Pension Schemes*, 1983). The average increase in pensions was 24 per cent between 1979 and 1981, about half of inflation. Response to the survey was voluntary and most probably biased to the best performing schemes. Yet, accepting the NAPF evidence as being representative of the entire field, a typical occupational pensioner receiving £33 a week will see that purchasing power steadily diminish. Each year he or she will be £2 a week worse off.

This failure to maintain benefits in line with price inflation is exacerbated when the purchasing power of most wage earners is continually rising. While price inflation runs behind wage inflation, and pensions are only linked to the former, pensioners will continually fall behind the standard of living of the rest of society. They will become increasingly unable to take advantage of new facilities in society and will become increasingly socially isolated. In 1979, the average occupational pension was £18 per week, while new pensioners received an average of £27 per week, half as much again.

Occupational pensions usually aim to provide either half of final pay on retirement, or two thirds of final pay including state flat rate pension, after 40 years' service. In 1979, the average male wage was about £100 per week. Members of occupational schemes were probably earning a good deal more than this because of the higher proportion of higher paid employees in schemes. Nevertheless, in that year, the average occupational pension was only about a quarter of the average male wage.

## Changing job and pension rights

This shortfall was the consequence of several factors in addition to the failure to match inflation. Many schemes were relatively new and so members had not had time to accumulate contributions. However, the nature of schemes is such that it is very unlikely that occupational pensions will improve very much on this situation.

The problems people face in transferring their pension rights when they change job adversely affect millions of contributors. Most workers in the private sector work where there is no scheme to transfer any pension right. Even if transfer is possible, the scheme accepting the transfer may reduce the pension entitlement as a condition of acceptance. Failing transfer, the employee may be able to opt for a deferred pension right: the normal requirement for preservation of pension rights in an occupational pension scheme is five years' membership, although a majority of the workforce changes jobs at least once before completing five years' service. Deferred pensions are only minimally protected against inflation: only a quarter of private sector schemes provide any increases in deferred pensions, and then at less than half inflation (NAPF, *op.cit.*). Where neither transfer nor preservation of pension rights is possible, employees simply have to take what refund they can get of their own contributions – losing the employer's contribution and the interest accrued on both contributions, and frequently subject to a 10 per cent deduction.

Workers moving from one public sector organization to another are more fortunate. Public sector transfers are usually straightforward one to another. However, preserved pensions, even in the public sector, depend on a record of service, usually a minimum of five years. Also, one in seven public sector schemes

makes no provision for increases in deferred pensions.

Most people change their job three or more times during their working lives, often losing future pension entitlements. A very small proportion of the workforce stays with one employer for the 40 years necessary for a full occupational pension. Although job changes have become less frequent with the deepening of the recession, still about one person in 12 changed job in 1982 (*General Household Survey*, 1983, HMSO). Every year between six and eight per cent of contributors lose their pension entitlements through job changes.

In 1979, mainly as a result of changing job, 1,150,000 members of occupational pension funds withdrew from membership, about one member in every ten. Of these withdrawers, only 7 per cent had their pension rights transferred to another scheme and only 13 per cent had their pension rights preserved. 59 per cent accepted refunds, and 15 per cent did not even get a refund (*Occupational Pension Schemes 1979*, op.cit.). Thus each year pension funds are freed of the obligation to provide pensions for about 800,000 people. Yet the contributions made by their employers and the interest accruing to both employer's and employee's contributions remain with the fund.

Defenders of the current system of occupational pensions point out that individuals have a choice to make when changing job. They should take their future pension entitlement into account when making their decision. Yet for anyone to make an evaluation of their future pension entitlement would require an omniscience far beyond that of the Treasury forecasting team.

For example, a 40 year old man would need to know his likely future career patterns with both his existing and putative employer for the next 25 years, and how this would affect his pension. He would need to know how much his existing pen-

sion would bring in if deferred. As deferred pensions often depend on discretionary increases to keep up with inflation, and as the ability to grant such increases depends on the fund's investment and performance in relation to inflation, among other things, the individual would need to know about the future management priorities of the fund, the health of its investments and future investments, and their ability to match inflation. With changing industrial patterns and an uncertain economic future, he is clearly in an impossible position.

This argument about individual choice and responsibility is obvious nonsense if one looks back 25 or only 15 years. Career choices made in low inflation, full employment circumstances in the late 1950s and 1960s may have seemed very wise at the time, but could have severely damaged pension rights now being collected.

## Redundancy and pension rights

Since 1979, millions of workers have been made redundant. Possibly one million employees have been compelled to withdraw from their pension schemes as a result of job loss. Only a minority of schemes have special provision for redundancy. Less than one scheme in three in the private sector has any provision for preserving or enhancing benefits in the case of redundancy and then usually only for those over 50 or 55. Half of public sector schemes have such provision. To the insecurity of unemployment is added the insecurity about pension entitlement in old age.

Those retaining some pension rights will depend on all sorts of chance in order to collect a decent pension. Those with deferred pensions in private schemes must depend on discretionary increases to keep up with inflation. Those with less than five years service in some parts of the public sector, e.g. local government,

can choose not to take a refund, but to get their existing service and contributions to count toward a future pension they must find another job within the same field of work.

## Women

Occupational pension schemes are not designed to cope with those who take time out of work for domestic or family reasons. With their poor provisions for people changing jobs, neither do they suit those who move jobs for family reasons.

Part-time workers are excluded from most schemes. Rates of contribution and pension would entail too much administrative expense per pound received. NALGO has recently launched a campaign (April 1984) for equal pension rights for women workers. Although agreement with employers (local authorities, water authorities, passenger transport authorities and universities) allowing part-timers to opt into existing pension schemes was reached in 1972, regulations were not drafted until 1980, and have still not been approved by the Department of the Environment. Such is the reluctance of even public sector schemes to accept this group of workers.

Women, as a group, are not well-served by occupational pension schemes. Their lower level of earnings and the large numbers working part time ensure a lower membership of schemes. In 1981, over three million women worked less than 25 hours a week (*Labour Force Survey*, 1981, OPCS, HMSO). Only 25 per cent of women working in the private sector are members of schemes, compared to 50 per cent of men. In the public sector, the figures are 55 per cent and 90 per cent (*Occupational Pension Schemes 1979*, op.cit.).

With their longer life expectancy, women are bad news for actuaries involved in designing schemes. However, some schemes provide benefits from women's state retirement age of 60, thus giving a small group of professional women a particularly favourable package.

## The pensions lottery

Contributing to an occupational pension fund is no guarantee of a secure pension on retirement. On the contrary, it is likely that most current contributors will get little or no benefit out of their present fund.

The vast majority of people change job three or four times during their lifetimes, and this is not likely to change. With each change of job, the security of their pension is put at risk. If they change job after less than five years service, they are likely to lose all future pension entitlement. Transfers are not usually accepted except between public sector schemes. A deferred pension is likely to fall rapidly in value. With an employment structure that may be subject to increasingly rapid change, few people can feel secure that their current contributions will guarantee them a secure and adequate pension. Even when they begin to draw their pension, they cannot feel secure. Many hundreds of thousands of occupational pensioners see the value of their pension rapidly shrink, as inflation marches on and their benefit remains static. And although supervised, pension funds operate in the market, which is, we are repeatedly told, about taking risks and making profits: there always remains the possibility that through poor decisions or bad luck, schemes can run into trouble and fail to provide the promised benefits.

## 4. Inequity of Provision

**Occupational pension schemes serve the lower paid and the more vulnerable sections of the population badly. Such people bear a disproportionate burden of the cost of providing occupational pensions, yet even if they have been within the scope of occupational schemes often gain little benefit from them when they retire.**

Schemes assume career progression for individual members. They exclude certain categories of workers, particularly part-timers and restrict benefits for those leaving before normal retirement age. They also operate in a tax climate which favours high income earners. All these factors conspire to make occupational pensions schemes major redistributors of income from the bottom of the scale to the top.

Within firms occupational pension schemes are often run separately for manual and white collar workers. These schemes have different rates of contribution and different benefits. Some companies run a scheme only for their white collar or managerial groups.

Only 28 per cent of pension scheme members are female, compared to 43 per cent of the workforce. Only six per cent of employees in firms with under 10 workers are members of schemes, and only 15 per cent of employees in firms with between 10 and 100 workers (*Occupational Pension Schemes 1979*, op. cit.). Low pay is most frequent among those employed by small firms. They are also more vulnerable to unemployment.

### Taxation

Pension funds enjoy a set of tax privileges on contributions and on investment in-

come, which makes them an attractive way of salting away funds if you can be sure that you will be around to collect. The Inland Revenue has costed the current tax relief to occupational pensions at £1,400 million for 1983/84. This comprises principally relief on employers' contributions, and on the investment income of the pension funds.

However, their method has come in for some criticism as underestimating the real value of the relief, particularly with regard to contributions by employers, which are treated as a deductible expense and not taxed as a benefit in the hands of employees. In response, the Board of the Inland Revenue have costed four other options for assessing the worth of tax relief enjoyed by pension funds using different assumptions on taxation. Two of these assess the value of the tax relief at £2,900 million, one at £2,450 million and one is very much lower at £650 million. However this lowest estimate is simply the cost of tax relief on lump sum payable on retirement or death. (Board of Inland Revenue, *Cost of tax relief for pension schemes: appropriate statistical approach*, 1983.)

The taxes avoided by the 11 million members of occupational pension schemes have to be paid by the rest of the population. With the bias in pension fund membership towards higher paid groups, this burden has to be taken by the less

well off, including the low paid, the retired, the unemployed and part-time workers. Tax relief is worth over £2 per week to the average scheme member on the current method of calculation. It costs the rest of the population of and over working age £1 per week each.

With the increasing shifts towards indirect taxation by this government, this burden falls more and more on the lower paid and least wealthy groups in Britain. Similarly the benefits do not accrue to each scheme member equally. Schemes for higher paid employees have higher rates of contribution and attract greater tax relief. The benefits go disproportionately to the highest paid and the wealthiest.

It is grossly inequitable that a worker not in a pension scheme should make a £2,500 contribution through extra taxes on his or her lifetime earnings to provide a pension for someone who is most likely to be considerably wealthier. Yet this is how the tax system operates for the benefit of pension funds.

## **Redistribution within pension schemes**

On top of regressive redistribution through the tax system, further maldistribution of contributions and benefits results from the design of the occupational schemes themselves. Again, the losers tend to be manual workers, the redundant, and those most vulnerable to unemployment. The successful career executive is the one who gains most if he (or, less likely, she) stays with the firm.

We have already seen the extent to which workers withdraw from schemes as a result of job change or redundancy. Their loss is the gain of those who remain in the fund. Employer's contributions, usually twice the employee's, are kept by the fund, as is any interest earned. Employer's contributions vary between 6 per cent and 18 per cent of the employee's

basic wage, averaging out at around 10 per cent. For someone on a typical wage of £130 a week, the employer's contribution is likely to be over £600 a year. Frequently, occupational pensions have been negotiated by trade unions as a 'deferred wage' including both employee's and employer's contributions. Those withdrawing from occupational schemes see the greater part of their deferred wage confiscated by the pension fund and used for others' benefit. Some see it all lost. With the high rate of turnover, trade unionists negotiating these 'deferred wages' for their members in any particular firm will be benefitting only a minority of their membership, as most will have left by the time it comes to collect a pension.

Supporters of an occupational system of pensions argue that this is a price which contributors knew they would pay when they decided to move job. Recently, many people have changed their employment without any choice at all. They have been made redundant.

Between 1979 and 1983, possibly a million people left their occupational pension scheme because they no longer had a job. This was a windfall for the pension funds, which were in deep financial trouble at the time. Approaching one million members lost any significant claim on their resources, yet the bulk of the contributions made on their behalf remained captive. The size of this gain has not been calculated, but it must run into many hundreds of millions of pounds, if not thousands of millions.

Although there have been many redundant executives and higher paid workers, the groups which suffered most from unemployment in the last four years have been manual and lower paid workers.

## **The final salary basis**

Over the years, pension funds have moved to base their pension on the final

year's salary of the individual member. This is particularly beneficial for the career managerial or professional worker, whose salary peaks in the final year. It is less suitable for other workers. Sir Keith Joseph has recently recognised that teachers who opt for less onerous and less remunerative jobs in their final years of employment will have a far lower pension than their contribution record warrants (*Guardian*, 28 February 1984).

The wages of manual workers over 60 are about 15 per cent lower than for those between 30 and 50, when the individual is fitter and prompted by the demands of family and home to do more overtime, to produce more on bonus or piece rates (*New Earnings Survey*, 1982, HMSO). Some pension schemes have come to recognize this inequity and base the final pension on the earnings in up to the three best of the last ten working years.

While this has gone some way to rectifying the situation in theory, in practice even moderate inflation makes the money wage in the last years at work the highest of a lifetime. Even in theory it still falls behind the state scheme, which aims at the best 20 years earnings, revalued with overall wage increases.

The result is that the manual worker receives a lower level of benefit relative to his or her contributions than the professional worker. In combined schemes involving both groups of workers, this involves a redistribution from one to the other.

Again it is the less well off who contribute to the welfare of the more affluent. A worker in the top 10 per cent of white collar earnings would contribute 211 per cent more to a pension scheme over 40

years than a worker in the bottom 10 per cent of manual earnings, yet he or she would retire on a pension 231 per cent higher simply because their earnings peaked at different times.

## Winners and losers

Occupational pension schemes have always been designed for employees in career professional and executive positions. This group represents no more than one in five of the workforce. Pension funds serve this group far better than any other occupational group or category.

Manual workers, the lower paid, those suffering from unemployment, women with domestic responsibilities, all get a far worse deal. Through the tax system or through the operation of the funds themselves they have their income redistributed for the future benefit of the most affluent group of employees.

Yet the operation of the pension funds is not consistent in this manner. Much depends on the unseen hand of the market. Changes of job and redundancy make the realisation of full pension benefits to professionals a chancy business. In an increasingly mobile society, few executive workers will receive a full occupational pension. They will have been members of schemes with no transfer arrangements, with redundancy provision at the wrong age, which did not index preserved pensions to inflation, etc.

Occupational pensions redistribute income in a regressive manner throughout society, but to individuals they also behave in a manner which is little better than capricious.

## 5. A Bizarre System

**Occupational pension funds are a bizarre way of providing for pensions. They involve building financial empires which threaten to take over the entire British economy. They also involve creating parallel bureaucracies to pay occupational pensions to millions of people receiving the state pension. They are run with archaic assumptions about employment which do little for equity in pension provision.**

Most civilised countries accept that those who have given forty or so years of work to that society have a right to a secure and adequate income after they have ceased work. The only way to do this is to transfer resources from those at work. In the current year something around £16,000 million will be transferred from those at work to the retired via taxes and the National Insurance fund.

Pension funds do the same thing but in a very round about way. Pension funds take contributions in from employees and employers and invest them in stocks and shares. To pay the pensions out the fund requires dividends from those stocks and shares. The dividends come from profits resulting from higher prices paid by consumers and lower wages taken by workers. Income is transferred from people at work to the retired, but with more intervening steps.

Pension funds have traditionally been paternalistic. Occupational pensions have been rewards for loyal employees. The construction of pension schemes has always taken this more or less for granted. They have been designed to provide for those spending a lifetime with the organisation. The contributions of early leavers have been treated like those who died in service, an additional source of income.

The design of schemes has taken life expectancies, rates of early leaving and

lengths of service into account along with the estimated rates of return on investment. The idea of an occupational pension as a right is a relatively recent concept, not yet fully accepted by the occupational pensions industry. Many are similarly resistant to the idea of pensions as 'deferred wages', maintaining the prerogative of the employer in setting up an occupational scheme.

Inflation proofing pensions in payment as of right has also been resisted by occupational schemes, often simply justified by inflation not being the scheme's or the employer's fault. The underlying reason is financial. Many schemes could not match inflation for pensions in payment or deferred, without massive increases in contributions.

### **Financial structure**

Until 1973, pension funds were effectively unregulated. They could deny early leavers any rights and ignore the pressures of inflation. As the 1973 and 1975 legislation's provisions come to bite, they will be required to do something on these fronts. Unfortunately, they have drawn their financial structure from this earlier, less responsible era.

What might have been appropriate for a small elite group of company employees

with lifetime service becomes monstrous and absurd for half the workforce. The restrictions on benefits from schemes are not simply unfortunate regulations which could be changed. Such arrangements have helped to keep contributions low. They are essential to the financial well-being of most pension funds.

Pension contributions come from both employee and employer, as a percentage of pay. They accumulate rights for a pension at final salary either at the rate of  $\frac{1}{60}$ th or  $\frac{1}{80}$ th per year. Thus after 40 years the member becomes entitled to either  $\frac{2}{3}$  or  $\frac{1}{2}$  final salary. If service is less than 40 years, then only a lower proportion of the final salary is paid. Hence, for any new scheme, there are many years when income from contributions is much greater than expenditure on pensions. The net surplus revenue of the scheme is invested in stocks, shares, property, government stock and overseas holdings to gain the best rate of return and so further reduce contributions and increase benefits.

The theory of this kind of institutional investment is that with a wide spread of investments, security can be obtained for the overall fund. It is also expected that over the long term the overall rate of return will be positive. Thus by investing contributions, pension funds can provide better benefits than a pay-as-you-go system. Pension funds usually assume a rate of return one per cent ahead of wage inflation and three per cent ahead of price inflation. This is to be achieved in the 'long run', usually reckoned at 50 years. Indeed, their performance in the last 50 years is around this.

## Investment record

It is in the nature of the market that some funds will be more secure than others. It is also likely that funds will have different rates of return on their investments. In practice, most managers have pursued

very similar investments. They seem to have gone into and out of investments in US farmland, UK property, overseas equities, all together. For example, in the third quarter of 1983, 26 per cent of all new money coming into the funds was invested overseas. Three months later, it was down to three per cent. Nevertheless differences in the prosperity of funds persist.

The behaviour of financial markets over the last 20 years has hardly been consistent. This has not helped fund management. In 1974, the average rate of return was minus 31 per cent, while wages rose by 29 per cent. In 1979, fewer than two pension funds out of 100 kept up with the rise in earnings and less than one third matched the rise in prices (Cubie, Wood & Co, actuarial consultants, cited in *Tribune*, 30 May 1980).

Things have improved since then. High interest rates have pushed the real rate of return into the black. A stock market boom has added greatly to the paper assets of pension funds. Over the past ten years, the rate of return on investments for pension funds is just over one per cent ahead of wage rises and  $2\frac{1}{2}$  percent ahead of price rises (*Financial Times*, 21 February 1984).

Over 20 years, things are less rosy. The average real rate of return has been one per cent negative. It could be argued that the market conditions of ten to 20 years ago were aberrations, which can be ignored in the view of long term performance. However, even over the last ten years, the percentage average return of pension fund investment has, in fact, fallen well short of FT Actuaries all share index. This index is derived from the stock market fortunes of the 750 largest UK companies. A fund manager who invests in all 750 companies in the same proportions as they are represented in the index is guaranteed a performance in line with the index. With an average run of luck, a randomly selected portfolio of shares will

also go up and down with the index (Clive Wolman, 'The threat from the computer', *Financial Times*, 30 December 1983).

The failure of most funds to live up to this index has provoked continuing controversy inside the management of pension funds, and continuing attacks on that management from a variety of points of view. Dealing costs, the radical changes in the stock market in the 1970s and numerous other factors have been advanced as explanations of this failure. Nevertheless, there is increasing pressure for 'passive' computer management of pension funds, i.e. simply to follow the average stock market performance. The larger funds are essentially locked into large investments. If they disposed of some investments, they could provoke company and even stock market collapse, and see little return for their effort. The pension funds now own so much of the stock on the market, that it is well-nigh impossible for their collective performance to differ very much from the market as a whole.

The job of pension funds is not simply to gain a modest rate of return in the long run; it is to provide an adequate pension in old age. It is questionable whether the performance of the funds over 50 years for a small minority of long serving employees has been adequate. Their performance as providers of mass pensions is certainly unproven, and the evidence to date is anything but reassuring.

## Growing like Topsy

Although their assets have been variously estimated at between £102,000 million and £120,000 million, pension funds have not stopped growing. Few schemes are yet 'mature' in the term used by the actuaries involved in devising and managing schemes. This immaturity springs from the fact that they have many more contributing members with future

pension rights than current pensioners. The sector as a whole has a surplus of income over expenditure of around £6,000 million a year. Postel, which manages the Post Office and British Telecom staff pension funds, has to find a home for £3 million income each working day.

With their huge net income, pension funds seem to have been taking over the British economy and a fair chunk of the rest of the world beside. In the last four years their assets have grown by £60,000 million. At the time of the Wilson Report on Financial Institutions, it was predicted that on the figures in the Report for their future growth, they would by the year 2000 have the resources to buy every quoted company and every Government stock, and still have enough change to buy over half the housing stock in the UK (*Tribune*, 4 July 1980).

While this growth is very impressive, it does seem a somewhat extreme way of ensuring pensions for those over 60 or 65 in the 21st century. Already pension funds own more shares than do individuals, almost 30% of quoted stock. This has enormous economic implications, but even with this financial basis, many of them have been unable to cope with the demands for pensions to keep up with inflation or to maintain pension rights for people changing jobs.

The very size of pension funds makes them inflexible. The smallest error in predicting rates of return or mortality could involve hundreds of millions of pounds. With assets of over £100,000 million, an error of one tenth of one per cent in the rate of return involves £100 million a year. Over ten years, at simple interest this is £1,000 million, if compounded far more. As long as it can be argued that some funds will be below the predicted rate and others above, unless the entire industry is overfunded, quite a few schemes will run into trouble in paying their final benefits.

## Narrow and inflexible

As pension schemes close by the score each year, this excess funding cannot be rolled over to later pensioners. While some funds might have to struggle to maintain benefits, there is the distinct possibility that there will be the few final members of well funded schemes who could become pensioner millionaires.

To ensure that a pension fund can meet its obligations to the last pensioner in many years time, a prudent manager will face the inevitable temptation to provide a margin of error against lower returns on investment or advances in longevity. With 100,000 pension schemes, this kind of prudence involves excessive total contributions (Mike Reddin, *The uneasy partnership: the state and occupational pensions in the UK*, London School of Economics).

Why should there need to be 100,000 schemes? For every 120 contributors and for every 40 pensioners there is an occupational pension scheme. In fact, many of the schemes are for one person only, and around 70,000 have less than 25 members; only 5000 have over 100. Many have no contributors and function solely to provide pensions for retired members formerly employed by firms long defunct. Such duplication of resources and provision for very small numbers of people is a further bizarre aspect of the world of pension funds. It is particularly so, when the giant funds of the Post Office, ICI and Unilever are considered, with their hundreds of thousands of members and thousands of millions of pounds of assets.

The narrow occupational basis of pension schemes mitigates against flexibility. Funds need to be able to meet all the demands on them if contributions stopped tomorrow. Prudent management will also ensure that those demands are minimised, if only to ensure that the youngest current contributor has a pen-

sion to collect in 80 years time. By minimising demands for inflation proofing, etc, 'prudent' management might succeed in providing a pension in 80 years time, but of negligible value. Not only pension managers of firms in trouble or in declining industries are likely to opt for prudence.

In meeting the demands upon them some funds do run into trouble. This was common in the 1970s, when many employers had to increase the level of their contributions to keep funds solvent. This happened when many companies were under severe financial pressure themselves. In order to avoid this there is further pressure for overfunding, whereby the contributions and investment return would provide a far greater benefit than is laid down.

The financial market conditions of the last ten years have provided a remarkable see-saw for pension funds. Five years ago many were in trouble and faced underfunding. Very many were considering contracting back into the state scheme at the next opportunity. Now some are overfunded. One Sheffield firm has secured the return to the company of almost £2 million surplus from its pension funds (Barry Riley, 'Pension fund investment', *Financial Times*, 21 February 1984).

Who is to say what the next five, twenty or fifty years will bring? Many pension funds now have greater assets than the organisations from which they sprung, and an increasing proportion of their income comes from investments rather than contributions. In the 1970s, schemes were very immature: they had few pensioners, and had made relatively few investments. Contributions made up a high proportion of their income. A failure of investment could therefore be met by putting up contributions, even if with some difficulty.

In years to come, the importance of investment income will continue to grow, as will the commitments of schemes. A

failure of investment income in ten years time will have a far greater effect on funds than it would have had ten years ago. The increase in contributions necessary to make up for a shortfall might prove an insupportable burden to the employer. For example, when investment income makes up 20 per cent of fund income and the rate of return drops by one-fifth, total income falls by 4 per cent: to make this up, contributions would have to rise by 5 per cent, say from 10 per cent of payroll to 10½ per cent. However, when investment income makes up 80 per cent of fund income, the same drop in the rate of return cuts total fund income by 16 per cent.

Contributions, now only 20 per cent of total income, would have to rise by 80 per cent, say from 10 per cent of payroll to 18 per cent.

The tying up of such huge funds, with the possibility of widely dissimilar benefits for pensioners who have had no choice over membership, does seem the most extraordinary way of ensuring that pensioners get a certain share of the national income. It is neither equitable, nor is it the most efficient way of transferring income from one section of the community to the other. The insecurity of many occupational pensions is testimony to this.

## 6. Accountability

Pension funds have traditionally been paternalistic. The employer has paid the majority of the contributions, sometimes all, and appointed the trustees, to ensure the fund is properly run. The trustees have operated under the Trustees Acts of 1925 and 1961. There is no specific pension fund legislation, and disclosure of information is scanty. Accountability to members is alien to the paternalistic tradition of occupational pensions.

Although the 1975 Social Security Pensions Act made membership of the employer's pension fund obligatory, it gave no rights of representation to employees who were, in effect, compulsorily levied. The Labour Government made moves in the direction of parity of union and employer trustees but nothing ever became law. Nevertheless, in addition to the long standing union trustees in various public corporation pension funds, there were moves among the funds to introduce employee representatives among the trustees.

### Employee trustees

While a majority of members of schemes have some representatives among their trustees, the parity found on nationalised industry pension funds is rare. The influence of employee trustees is also limited.

Fund managers present themselves as the technical experts they are. They present their decisions as being in the best interests of the fund. The trustees are obliged by the Trustees Acts to act in the 'best interests' of the beneficiaries. They are rarely in the position of dealing with the technical case put forward by the fund manager, and even more rarely do they have the power to challenge it.

Increasing attention has focussed on employee and union trustees in recent years. Trade unions and the TUC have made considerable efforts to inform and train trade union representatives as trustees. However, there is a long way to go.

And attention has tended to be directed toward the investment side of pension fund activities. As one employee trustee remarked during a recent survey carried out from Glasgow, 'There I was, supposed to be making a £2 million investment decision and me wondering if I had 20p for the bus fare home' (Tom Schuller and Jeff Hyman, 'Plums, paper bags and pensions', *New Society*, 18 August 1983). Not only has the confidence of worker trustees to challenge investment decisions been lacking, but so has interest on the workforce in them. The National Union of Journalists recently had to cancel a workshop on pension funds due to lack of interest among members.

While people rarely feel qualified to deal with esoteric investment decisions, many are concerned about their pension rights. The response to the Fowler inquiry has brought out evidence of this. Employees are concerned about a secure pension, and about their rights if they change job. If trade unions concentrated

more on this area of occupational pensions, they might get a more positive response and a good deal more influence.

## More power to the city

The real control of pension funds does not lie with trustees. It is in the hands of those who manage the funds, effectively 2,000 people in the City of London (Wolman, *op.cit.*). About one third of funds are managed 'in-house', i.e. by the fund's own employees. Two thirds are managed by financial institutions, primarily merchant banks and insurance companies. The top five city institutions manage funds to the total value of £20,000 million (Riley, *op.cit.*).

The very small occupational pension schemes, which as we have seen make up the greatest proportion of the 100,000 in existence, are nearly always managed by a financial institution of some kind, commonly an insurance company. However, the largest, which have hundreds of thousands of members, are nearly always managed 'in-house'. Postel have 91 staff to manage the £7,000 million assets of the Post Office and British Telecom pension funds.

Over the years, the insurance companies have lost a large share of this market to the merchant banks and some 'in-house' management. This is one of the reasons they are protagonists of 'portable pensions'. They hope to regain their market. Nevertheless, all groups use the same financial logic for their investment

decisions. Personnel frequently move from one institution to another to do a similar job.

The growth in the assets of pension funds has been represented as a democratisation of capital. Any such potential is certainly unrealised. The managers of these funds have little control put on them from the workers whose contributions they manage.

For many years the pension funds were very passive shareholders. While this still remains the case generally, there have been recent indications of their power. In 1983, nine funds joined together to bring about a change of top management at the Rank Organisation. The Post Office Fund stopped the attempted £750,000 golden handshake to Jack Gill on his departure from Lord Grade's conglomerate business empire.

They have also been major participants in taking up privatised shares from Government sell offs. The British Aerospace pension fund is the largest shareholder in British Aerospace, with a £135 million stake. Investment decisions such as these are only in theory made by the trustees. It is rare indeed that they are in a position to challenge the recommendations of the financial managers of the funds. Under current legislation and structure, there is nothing remotely resembling democratic control of pension funds. They are much more an addition to the financial power of the City of London (Richard Minns, *Pension Funds and British Capitalism*, Heinemann 1980).

## 7. Conclusions and Alternatives

Occupational pensions are an ineffective and archaic way of attempting to ensure adequate pensions for most of the population. In terms of providing a secure income after retirement, and in terms of actually providing benefits for a majority of contributors, occupational pensions are a lamentable failure.

### The indictment

Pensions fall behind inflation, often dramatically. Preservation and transfer arrangements for the pension rights of those changing job and those being made redundant are frequently scandalous.

The weaknesses of occupational pensions are characteristic of private welfare. Only a minority of members at any one time will benefit from their current contributions. Those who will benefit least will be the lowest paid, and the most vulnerable. They subsidise the more affluent and secure sections of the population.

Arguments by protagonists of occupational pensions maintain that these failings are either temporary or are due to inadequate coverage by occupational schemes. Neither of these positions stands up to scrutiny. The 'temporary' failings of funds in respect of the great majority of the workforce who spend less than 40 years with one employer have been around since the beginnings of occupational pensions a century ago. The restrictions are still defended by pension fund managers. They underpin the financial health of many schemes and have been planned into their structures.

The 1975 Social Security Pensions Act

places some additional requirements on schemes, but allows them to behave in much the traditional way with contributions above the Guaranteed Minimum Pension rate. Apart from those who retire directly from a scheme, other contributors will be no better off than if they had been in the State Earnings Related Scheme all their working lives. Indeed, they can be worse off.

It is still another 15 years before SERPS comes into full operation and those retiring over the next few years will find their occupational pensions only minimally protected by the 1975 Act.

At a time when occupational structures are admitted by all to be rapidly changing, it is archaic to base future pension provision on today's occupations. Those retiring in 2026 will have radically different occupations from today's.

It is bizarre to build financial empires, which will increasingly dominate the economy in the 21st century, on the occupational basis of the 1970s. This is particularly so when the occupational basis being used is not entire sectors, nor even entire firms, but sections of these. Firms commonly have two schemes and often three or more for different parts of the workforce.

The duplication and triplication etc of the effort so involved is highly inefficient.

It can only be justified on the basis of competitiveness in the market. Yet there is no choice involved in joining an occupational pension scheme. It is nearly always a condition of employment.

It is a contradiction to base future welfare provision on the basis of compulsory contributions, and make the delivery of the benefits dependent upon the market success of the investment manager.

The mechanism of building up a fund over many decades to ensure that future generations transfer a proportion of their income to the aged does also seem unnecessarily complicated. Like any return on investment, it is an expense which is passed on in either lower wages or higher prices to those working at the time.

It is argued that occupational funds free the taxpayer from the burden of supporting pensioners. With tax relief, this is only partly true. Nevertheless, the wage-earners through having to provide a higher return on investment for the pension funds contribute equally to the pensions of the elderly. Only the mechanism is more complicated. Because of the complicated nature of this mechanism, it is more expensive than a pay-as-you-go system which simply transfers taxes into pensions. It is also less effective at transferring income from those who can afford it to those who need it.

Pension funds have become enormous accretions of financial power, effectively responsible to nobody. The members of the schemes have no legal entitlement to representation among the trustees of the fund. Even when this representation is granted, they are nearly always in a minority.

The growth of pension fund ownership of the British economy is proceeding at a great pace. It is not a democratic takeover. It is placing the control of these funds in the hands of about 2,000 investment experts in the City of London.

Such economic power allied to the provision of benefits for a sizeable minority

of the population gives occupational pensions a tremendous hold over future provision for the elderly. They are inflexible institutions, with given sets of rights and levels of contribution and benefits. They are based on demographic and investment predictions looking forward half a century. A dramatic increase in longevity would be very bad for them. Expropriation of investments in certain sensitive locations would not do them any good either.

Occupational pensions hinder the ability of the social security system and of society in general to respond to changing needs. An over-exposed pension fund might fail to meet its obligations in 2010, and its hapless pensioners would be cast upon the supplementary benefit minimum. Indeed under present Government ideology, they made the wrong choice by working for the wrong employer with the wrong scheme in 1984. They must bear the consequences.

As institutions mainly promising for the future rather than delivering in the present, occupational pension funds have a positive image. With the passage of time, increasing numbers of people are coming to know the benefits they will not get. So this image is beginning to change. The pressure for better provision for early leavers is a sign of this changing public view.

## **Portable pensions**

The proposals of the Centre for Policy Studies and others for personal, portable pensions claim to solve the problem of preserving pension rights. As we have seen, job changers do get a poor deal from pension schemes. Clearly some personal pension entitlement would be better than none at all. Yet a closer examination of the proposed portable pensions reveals them to be subject to similar deficiencies in terms of insecurity, inequity, inefficiency and lack of accountability as the pension funds.

Portable pensions are not a secure way of providing for old age. The radical suggestions of Nigel Vinson and his colleagues at the Centre for Policy Studies would involve the elimination of all compulsory pension contributions and leave the individual free to do as he or she wants with what would have gone in contributions. He or she could put it into a private pension scheme run by an insurance company, or into a unit trust, or indeed invest it themselves. If the someone chooses a scheme which performs poorly, then the individual has only him or herself to blame.

The Centre argues for personal financial responsibility for old age via ownership of pension or income rights. This is a return to Victorian values with a vengeance. It is also plainly ludicrous to place the choice and investment responsibilities on the individual, when the major pension funds investments themselves have failed to match the market over the past ten years. He or she will only be able to examine a few nicely packaged brochures and take what is little more than pot luck.

Security will not be helped by the vagaries of employment change. What will a period of unemployment do for the individual's pension entitlement? Will he or she be able to meet the premiums? If not, will they lose all rights? What may seem a sensible decision today, may turn out to be disastrous for old age because of employment changes in 20 or 30 years time.

With some kind of collective provision for old age, society bears a responsibility to ensure a decent income in retirement. With a purely individual system, all the responsibility falls on the person themselves. The insecurities of investment in the market, of job loss, of inflation, of ignorance about what to do all remain.

Inequality of pension provision can also be laid at the door of personal choice. Those who have a poor pension simply

made a poor choice. Society will feel no obligation to maintain the dignity of a retired person who has contributed his or her work to it for decades, if personal investment choices do not work out.

Inequity will result from the same causes as insecurity; job loss, investment failure for whatever reason, and general bad luck. While some early leavers will gain, the people who will suffer most will remain the poorest and most vulnerable groups: the low paid, the unskilled, the unemployed and women.

Small contributions require as much administration as large ones, so the benefits offered are likely to be even more than proportionately smaller. Administration will take a greater slice of the cake from the lower paid. The low paid will only be able to make smaller contributions out of their income and so attract less tax relief under any new system.

Unskilled workers who are most frequently involved in job changes and suffer bouts of unemployment will have all sorts of problems maintaining a full contribution record. Their entitlement to benefits is therefore most likely to be adversely affected.

Women, many of whom work part-time or take interrupted periods of work for family reasons, have least reason to support the idea of personal pensions. With the problems of low contributions and broken contribution records, they will receive a very unfavourable package of benefits from any offering institution. As women live on average five years longer than men, one major effect of personal pensions could be deepening poverty for elderly women. A set of contributions which might give a man a decent pension until 70, would ensure a much lower standard of living for a woman until 75.

Why replace the inefficiencies of 100,000 pension funds by the inefficiencies of millions of personal pensions? One form of duplication is simply replaced by another, which is likely to be worse.

Why replace the financial empires of the pension funds with those of insurance companies and unit trusts? Their investment records are so similar as to be identical. They will form the same absurd economic mechanism for transferring income from the workforce to pensioners. The channels will be just as insecure and unsuitable as now, and the administrative inefficiency is likely to be greater.

All chance of accountability will go under a system of portable pensions run by the major financial institutions. The pension will cease to be a right and simply become a contract. If the contributor fails to fulfill his side of the contract, then that is his or her problem. The institutions simply provide a market return.

## **Implications for privatisation**

Personal portable pensions will not only undermine existing occupational pensions in the private sector. They will undermine occupational pensions across the public sector and the State Earnings Related Pensions Scheme.

While public sector schemes suffer from many of the drawbacks of their private sector analogues, they do provide better protection against inflation, and better transfer arrangements. They also benefit a significant number of low paid workers.

In 1980, the Scott Committee was set up by the Government to examine the de-indexing of public sector occupational pensions from inflation linked rises. In spite of a supposedly rigged four to one majority, it was unable to recommend any change. Indeed it expressed the hope that private sector schemes would perform better in this respect.

Public sector schemes are a major problem in the privatisation plans of this Government and have caused more than one set back. Plans to privatise certain

Civil Service functions have had to be abandoned because of the cost of setting up a funded pension scheme in place of the present pay-as-you-go Civil Service Pension Scheme. In 1983, the Government had to abandon plans to privatise heavy goods vehicle testing stations for this reason.

Other sell offs have been held up by the necessity of adequately funding pension schemes to match present benefit levels. Of the £52 million raised in selling off the National Freight Corporation, £49 million had to be allocated to the pension fund. The proposed sale of a 50 per cent share of Royal Ordnance Factories will actually cost the Government £100 million. The sale is expected to raise £150 million, but the setting up of a pension fund will cost £250 million.

British Telecom's £4,000 million pension fund is still carrying a deficit of £1,250 million from the days when the Post Office was a Civil Service department with an unfunded pension scheme. British Airways have actually stopped new employees entering their index linked scheme, and they have set up a less generous scheme for them. Existing scheme members are being offered an average of £8,000 each to switch schemes. The total cost could again come to £250 million (*Financial Times*, 26 January 1984).

## **An attack on the state scheme**

The State Earnings Related Pension Scheme already has to bear the burden of maintaining guaranteed minimum pensions in payment, supporting revaluations of some preserved GMPs above a certain level of inflation and buying back people with less than five years contributions to occupational schemes. The National Insurance Fund from which it is paid also suffers from a loss of contributions of a very high proportion of above average

income earners through contracting out reductions.

Over the next 15 years, its payments are due to increase markedly as entitlements rise. The review of all pension provision being currently carried out by this Government will want to avoid this drain on public expenditure. Portable pensions give the Government a chance to replace the burden of pension provision by the state with a private system.

The State Earnings Related Pension Scheme does not suffer from the major disadvantages of personal or occupational provision. Job changers simply keep on contributing to the same scheme. Benefits are indexed and linked to the best 20 years earnings thus not disadvantaging women and those who are for a period low paid. It operates in the most efficient way by simply redistributing national insurance contributions as pensions. It does not have the dead weight of a massive fund, and so could be much more easily enhanced to meet changing needs.

For the higher paid, it has disadvantages. It does not count earnings above £250 a week for benefits. In combination with the state flat rate pension, it is also redistributive towards the lower paid in pension provision.

There are also major fears about its cost. John Kay of the Institute of Fiscal Studies (IFS) has argued on very pessimistic assumptions that SERPS could require National Insurance contributions to rise to 25.5 per cent of earnings in the next century – equivalent to an income tax increase of nine pence in the pound.

Opponents of the state scheme are spread across the entire right half of the political spectrum from Dick Taverne of the SDP and the IFS to Nigel Vinson of the Centre for Policy Studies. With the powerful institutional backing of the insurance companies and the Institute of Directors, among others, the abolition of SERPS is a distinct possibility.

## Immediate developments

This possibility is receiving little attention at the moment. The centre of the debate is the duel between personal portable pension protagonists, backed by right wing pressure groups and the insurance companies, and occupational protagonists backed by the Confederation of British Industry and the pension funds.

Outright victory is unlikely to go to either group. However certain compromises are possible. The Centre for Policy Studies propose an intermediate stage where employees can choose between portable and occupational pension provision. This seems a recipe for chaos. Certain job changers might be better off, but the combined inefficiencies of both personal and occupational pensions would be a disaster for contributors and pensioners alike.

The proposals of the Legal and General Assurance Company are more insidious. Portable pensions would not be compulsory, but negotiated between employers and employees. There would be disincentives to participation by young people to safeguard contributions to existing occupational schemes. The main aim of these proposals is to increase private provision at the expense of SERPS by encouraging contracting out in favour of personal portable pensions. Thus the main financial institutions can reach a compromise with each other at the expense of state pension coverage.

Improving the rights of job changers is another possibility. Norman Fowler has said that he intends to introduce legislation to allow pension rights to be carried over by job changers and to be revalued at five per cent a year. This addresses part of the problem. However, it still does not match present, much vaunted inflation levels. Given previous experience, such legislation is likely to have many exclusions and limitations upon length of service etc. It still does not address the major prob-

lems of inequity and inefficiency in the present system. It is a patch up job, which could well come apart under economic pressures in a few years time.

Other possibilities remain. Even if they are not going to be taken up by the present Government, they should be examined for the possibility of future action.

## **Adequate pensions for all**

The first question which needs to be answered, is, can this society actually afford an adequate pension for its retired population? The answer to this question is undoubtedly yes. Between them state and occupational provision absorb about £30,000 million in contributions. To pay this out to the existing nine million pensioners equally would give each one of them over £60 per week, well over the current pension for a couple, and approaching twice the basic flat rate pension for a single person; while this could not seriously be proposed, it is a crude measure of our ability to afford decent pensions for all.

Actual numbers over retirement age are declining, and this should continue for the next few years. At the end of the century numbers of over 60s should rise a little but not dramatically. For the next 20 years, the current resources devoted to pensions could eliminate poverty in old age if they were distributed more evenly.

Demographers predict 12 million pensioners by 2030. However, as Norman Fowler has told the House of Commons, if earnings grow two per cent faster than prices, then to fulfil the SERPS level of benefits, the level of National Insurance contributions could fall by 2 per cent. This is the current trend. It is also that used by actuaries in constructing occupational schemes. However, it does seem somewhat chancy to predict the tax burden 46 years hence. Attempts to do this in 1938 for today would have been abysmal failures. The demographic predictions

made in the 1940s also proved quite inaccurate. There is certainly no conclusive evidence to justify destroying a scheme which has barely begun and does not on any calculation pose financial problems for several decades, and probably not then.

## **Alternatives**

If we can afford a decent level of pension for all, it is necessary to examine what alternatives would enable us to provide it.

### **A reform of occupational pensions**

Occupational pensions could be reformed. Full transfer and preservation rights could be granted to match inflation. Pensions in payment could be index linked. Legislation would be necessary on all these points. However, these requirements could not be fulfilled in the long term by occupational pension funds as currently constituted: they would bankrupt schemes or place an unknown liability on employers. Moves could be made in this direction, but they would require more resources to be put into these archaic and inefficient institutions.

True occupational pension schemes could be created by the amalgamation of all schemes in an industry. This would also have to be brought about by legislation. Such rationalisations of private enterprise are not unknown. It happened with the railways in 1922. A pension system analogous with the French model would be created, although with different funding arrangements. However, it is ridiculous to base the pension provision for the 21st century on the current occupational structure. Pension funds for the retailing trade, for public services, for information services might have the same occupational base to meet changing needs in 20 or 30 years time. But what of

the once dominant textile industry, or steel, or even vehicles? An occupational structure created at the beginning of this century would have had to cater for a million domestic servants. Such a system is less vulnerable than company based schemes, but, as the French have recently found, it eventually runs into the problems of inflexibility in the face of economic changes.

### **State flat rate provision**

Priority could be given to the state provision of an adequate flat rate pension. This would be the quickest and most straightforward way of dealing with poverty in old age. Denmark and the Netherlands have given priority to this mode of provision. In contrast to a British basic pension for a married couple valued at under 40 per cent of an average male manual worker's pay, the Danish pension equals 57 per cent and the Dutch 62 per cent.

However, such a move is fraught with enormous short term complications. SERPS would have to be abandoned and support for occupational schemes ended. It would necessitate preserving the existing guaranteed minimum pension rights for those who have contributed since 1978 in a similar way to the preservation of graduated pension rights after that scheme was terminated. People who have contributed to a state earnings related scheme must be allowed the benefits for which they have been told they are due. A repeat of the Conservative abolition of earnings related supplement on sickness and unemployment benefit would be doubly indefensible in the case of pension rights. The current system of earnings related contributions was introduced at the same time as the State Earnings Related Pension Scheme.

The occupational pensions sector would be thrown into chaos. Virtually

every scheme with contributing members would have to be redesigned. With the loss of their tax advantages, the schemes would face financial disaster.

A state flat rate pension is a hostage to fortune. It is the target of Nigel Lawson in his drive to cut overall payments on pensions. The last two Labour Governments have also found it an inadequate tool for dealing with poverty in old age. Millions of people would consider their futures threatened by such a move. It would seem a non-starter for political as well as technical reasons.

A further argument against such a radical move is that the European countries which provide the most adequate pensions upon retirement do so on an earnings related basis. Within the EEC, Italy, Luxembourg, Belgium, France and Germany all provide average pensions for married couples of 60 per cent or more of the average manual worker's wage. Sweden also operates a system of which SERPS is a less generous analogue, with a pension based on the best 15 years earnings out of a minimum contribution period of 30 years. However, such systems may be less of a guarantee against individual poverty than a flat rate system.

### **Building on SERPS**

The State Earnings Related Pension Scheme suffers from few of the drawbacks of the occupational schemes. Yet it is tied into their inflexible structure and has to suffer burdens they are unwilling to take on in terms of benefit provision. It also loses income through the contracting out reductions and the tax benefits the schemes enjoy. Yet, at its inception, it took a strong campaign to get many pensions schemes to contract out of the scheme. After five years of poor investment performance, many schemes were considering contracting back in at the next opportunity.

With the removal after an adequate period of notice of the tax advantages enjoyed by occupational schemes which have contracted out of SERPS, the vast majority of them would eventually have to contract back into the state scheme. Such a move would deal with the tax inequity currently suffered by non-scheme members. It would also ensure that scheme members did not suffer from the internal inequities and insecurities of the current occupational set up. The demands on the state scheme would increase, but so would contributions to it. A large amount of the needless duplication of pension provision could be avoided.

Such a move would provoke resistance. Schemes would point to the theoretically better levels of pension they claim to provide. This would undoubtedly elicit a response from many members, especially in the public sector. The top ten per cent of income earners would find a part of their income not counting for pension purposes within SERPS. Existing contracted-in schemes however answer these objections. They allow for benefits to be provided on top of the state scheme. Those who wish to make additional contributions for their retirement in this way need not be prevented from doing so.

Such a move would provide for earnings related pensions for all employees to be provided through the state scheme, with security and with equity. It would also allow those who wished to do more in terms of provision for retirement to make arrangements on top of the state scheme.

### **The short term**

There still remain the problems of occupational pension contributions prior to 1978 and benefits now in payment. The millions of people due to retire in the next few years and those on insecure and declining pensions do deserve some action on their behalf. It will also be

necessary to ensure some effective regulation of the extensive, if minority, of pension funds contracted into the state scheme.

Simply taking over the existing funds in a state network, while guaranteeing benefits, is initially an attractive idea. The current inflow of funds greatly exceeds expenditure, and so there should be no difficulty in meeting the demands for pensions from a conglomerate state pension scheme. However, such a move must be rejected for a variety of reasons beyond its likely portrayal as a state pension grab. There are technical reasons for its rejection. It would involve the most cumbersome short term administration, probably beyond the immediate capacity of the Civil Service. It would also require the public exchequer to guarantee some very expensive pensions designed for very rich individuals. It would offend against the principle of accountability being promoted in trade union circles. While it might deal with the problems of insecurity of pension provision, it would involve the perpetuation of many of the inequities of the present occupational system, but funded and administered by the exchequer and the Department of Health and Social Security.

It would seem much more sensible to restructure the present arrangements to serve for the short term. Three elements would seem to be essential for this kind of restructuring; amalgamation, a code of basic rights for members, and accountability to members. Restructuring along these lines would be more difficult to represent as a state grab for people's pension money. It would also avoid the main technical and principal difficulties of state takeover.

Amalgamation is necessary to deal with many small schemes, often with poor levels of benefits and very unbalanced membership structures. It would minimise the tendency to overall over-funding of schemes. Transfer and other administrative arrangements would

also be simplified. While an occupational or industrial structure is inappropriate for three quarters of a century hence, it should manage the job for the next 15 years.

Basic entitlements of members need to be guaranteed in a simple way, with benefits guaranteed because of contributions and not subject to escape clauses ex-

cepting short term service or lack of provision for inflation.

Accountability to the membership is a basic right. If people make contributions to a pension scheme, then they should have some control over it. With an adequate level of accountability, more than basic rights to members should be assured.

**Reform of the system of pension provision is a major social, administrative and economic undertaking. It would provoke strong opposition from financial and other circles. However, to provide adequate and secure pensions for more than a minority of the population, the present system cannot be allowed to continue. The current groundswell of resentment against occupational pension funds' treatment of those changing job is an indication of the public pressure for a fairer deal on pensions. The necessity is to channel that pressure towards a better deal for all. It is time for the Labour movement to break away from the restrictive agenda of the Fowler inquiry and take a lead in the real national debate which has yet to begin.**

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