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# UK pension reform: much under way with more to come?

Carl Emmerson

Presentation at "Pensions in HE – annual schemes update", London, 7th March 2012

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# Outline

- Public service pensions
- Moving to a flat rate state pension
- Increasing state pension age
- Workplace pension reforms

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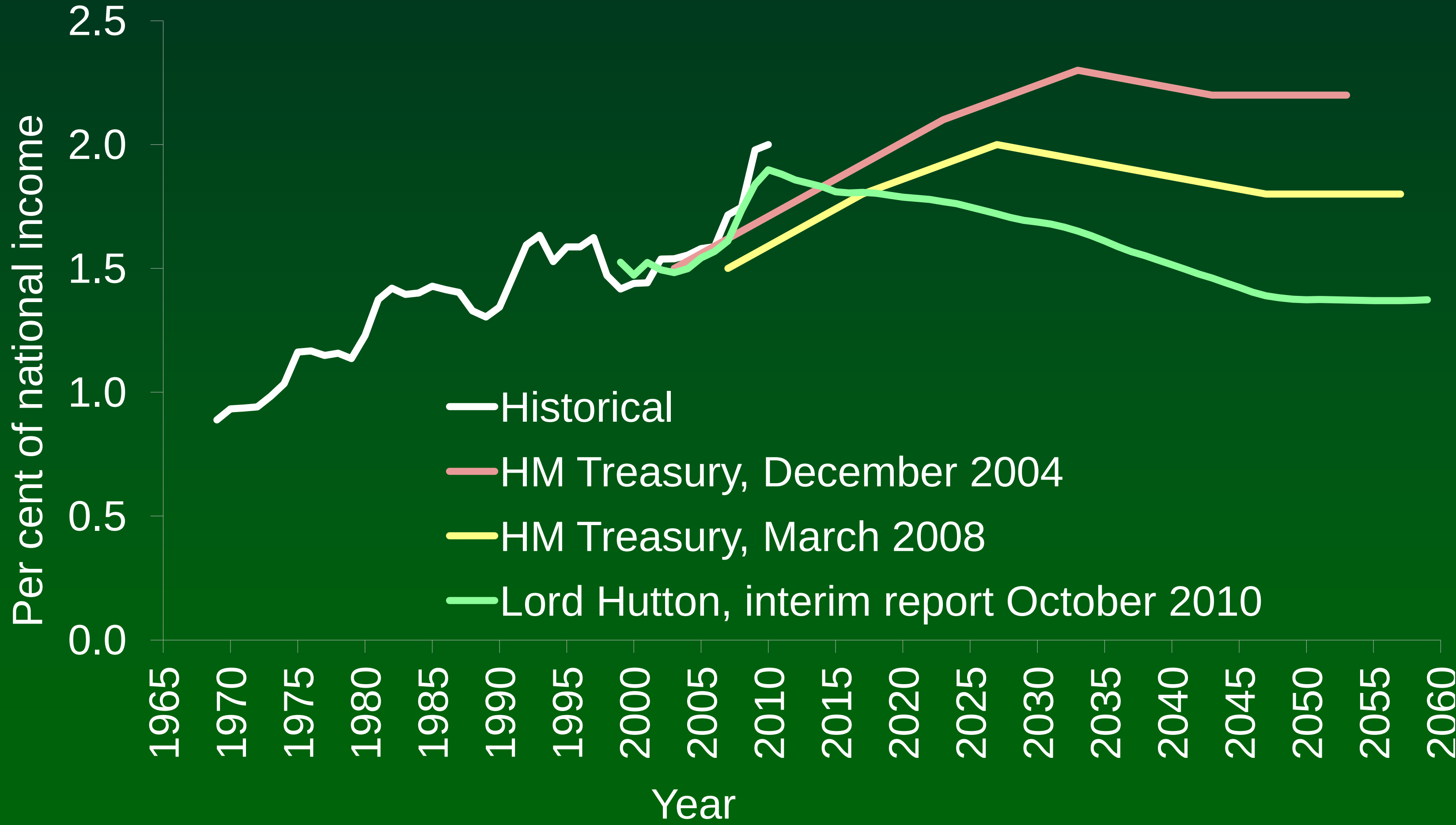
# Spending on public service pensions forecast to fall as a share of national income

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Notes and sources: see Figure 5.1 of *The IFS Green Budget: February 2012*.

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# Latest reforms do much to improve structure of pensions

- Defined benefit schemes retained
  - state particularly well placed to offer these schemes
- Career average rather than a final salary basis
  - more logical measure of earnings to use
- Normal Pension Age aligned with State Pension Age (except for uniformed services)
  - a coherent response to rising longevity at older ages
- Changes apply to future accrual (apart from those less than 10 years from current NPA)
  - reduces extent to which individuals doing the same job for the same pay accrue different pensions

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# Valuing public-service pensions

- Difficult to do
  - doesn't just depend on scheme rules
  - also depends on longevity of individual and their partner, discount rate, earnings trajectories and pension tenure
- Clear that the latest reforms do reduce the generosity for some
  - those protected from Labour's reform could see their NPA increase from 60 to 68 for new accrual
  - civil service scheme made less generous
- But for others not clear there is an overall reduction in generosity
  - high flyers with long tenures did very well under final salary schemes and lose from the shift to career average
  - but those with lower earnings growth, on average, gain

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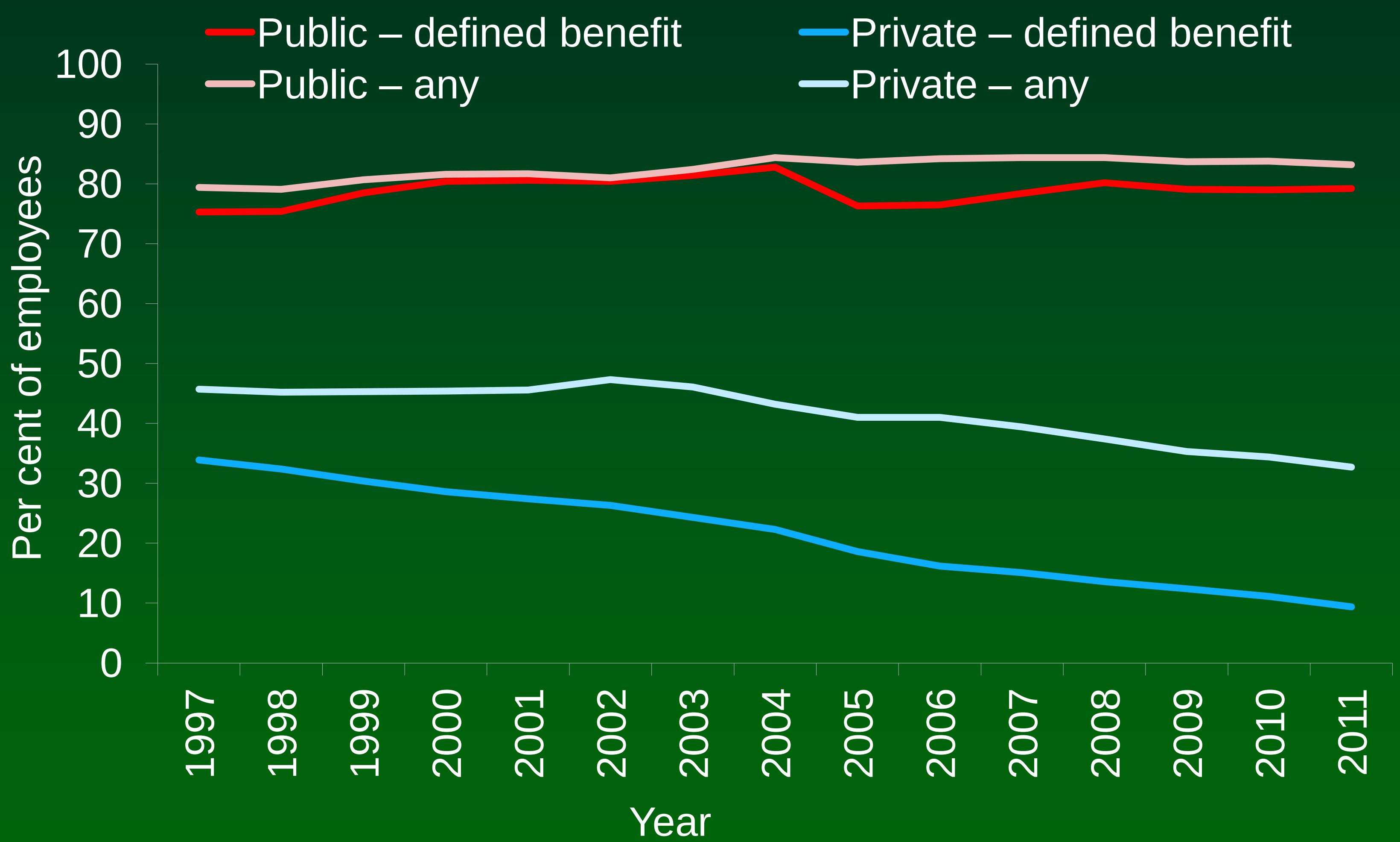
# Public service pensions remain much more generous than those provided in the private sector




Source: Author's calculations using data from the Annual Survey of Hours and Earnings.

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# Moving to a simple flat rate state pension

- Option 1: move to flat rate accrual of S2P sooner
- Option 2: move to flat rate state pension in payment sooner
- Implications for individuals:
  - going forwards higher earners accrue lower state pension, lower (lifetime) earners and self-employed accrue greater state pension
  - reduced reliance on means-tested benefits; those who would not otherwise take up their entitlements would be big winners
  - a simpler state pension system would arrive sooner
- Intention to leave public spending on pensions unchanged, so gains have to be offset by losses under both reforms
  - option 1: easily done
  - option 2: Pension Credit Savings Credit to be abolished and no State Pension paid to those with fewer than 7 years contributions
- Contracting out of DB schemes to end

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# “A state pension for the 21st century”?

- Should individuals plan on the basis of expecting £140 a week, triple-locked?
- Recent history suggests maybe not:
  - indexation to greater of prices or earnings previously broken
  - “This is our New Insurance Contract for pensions. This Contract will deliver the security we all want, now and for the future.” (DSS, Green Paper, 1998)
  - “Pensions policy has to be for the long term. If we want people to plan for the future, stability in the framework of pensions policy is a key component.” (DWP, Green Paper, 2002)
  - “These reforms set the direction for the long-term future of pensions and retirement savings. They will create a system that is coherent, comprehensive and which will stand the test of time” (DWP, White Paper, 2006)
- But perhaps a simpler system will prove more durable?

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# Increasing state pension age & individual behaviour

- State income reduced while aged between old and new SPA
  - those moving onto health-related or means-tested benefits will see at least some of this loss recouped
- Many will have to choose between
  - increasing earnings (including later retirement)
  - reducing spending during working-life (i.e. increased saving)
  - reducing spending during retirement
- Retirement ages could also rise if SPA provides a signal of the ‘appropriate’ age to retire
  - SPA is the most common retirement age
- Retirement ages likely to increase (but by less than SPA increase)
  - partners of those directly affected might also respond

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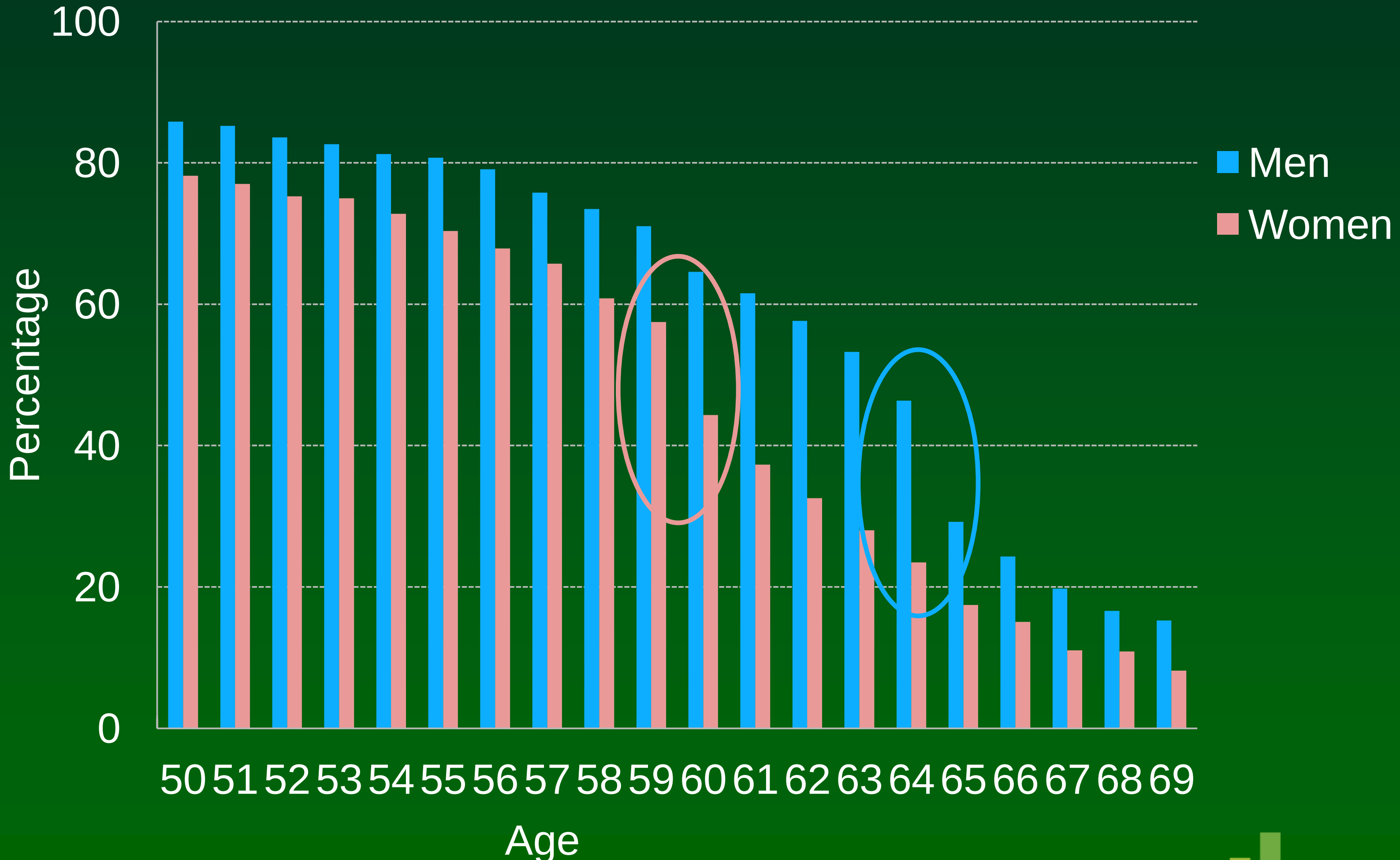
# Employment rates, by sex and age




Source: Labour Force Survey, data for 2007, 2008 and 2009 pooled. Weighted.

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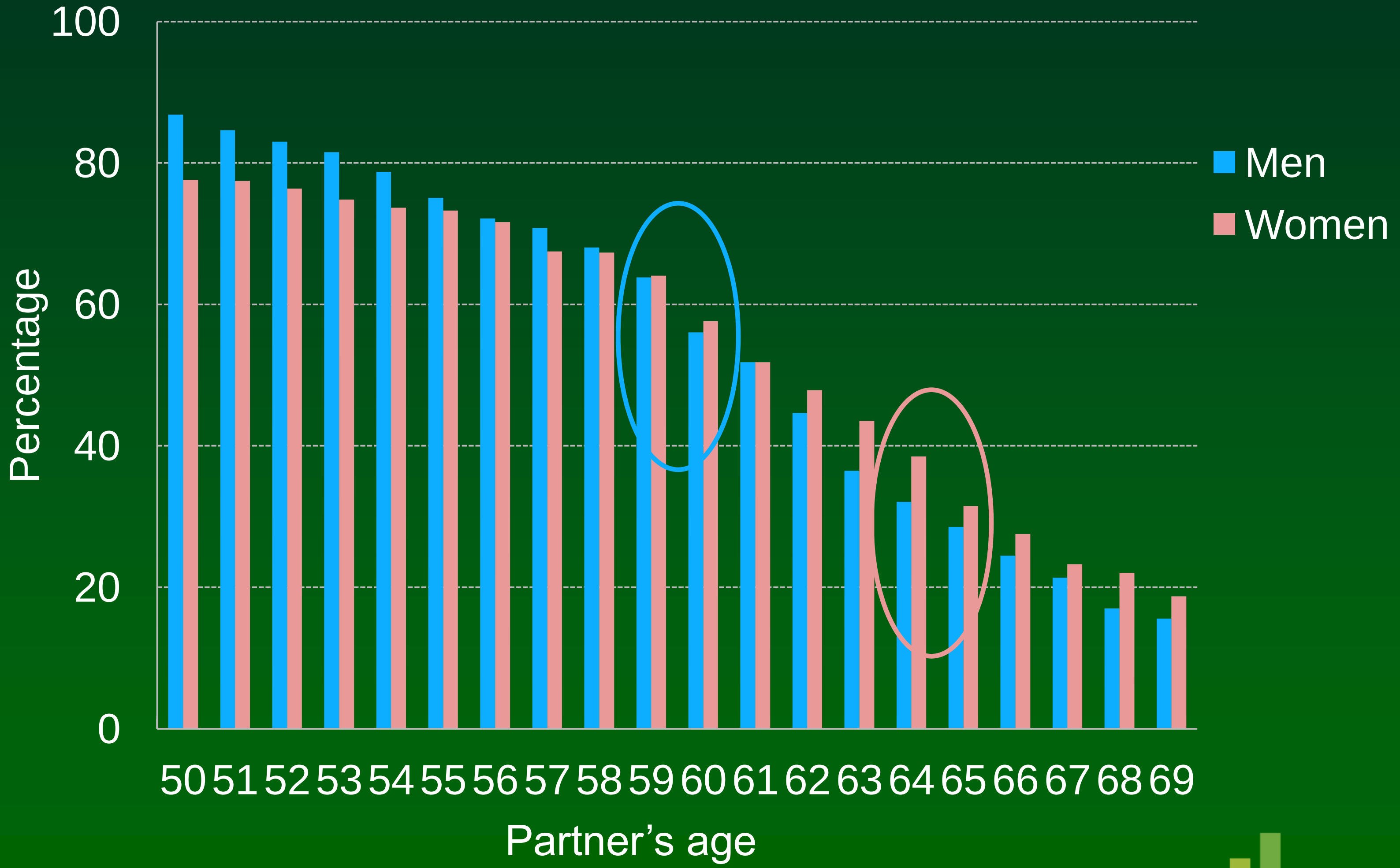
# Employment rates, by sex and partner's age




Source: Labour Force Survey, data for 2007, 2008 and 2009 pooled. Weighted.

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  - SPA is the most common retirement age
- Retirement ages likely to increase (but by less than SPA increase)
  - partners of those directly affected might also respond
- Biggest losers might be those who would like to work more but are unable to do so



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# Role of workplace pension reforms

- Employers to enrol employees automatically into a private pension which complies with certain minimum standards
  - all those aged 22 to State Pension Age earning more than £7,475
  - those opting out to be re-enrolled every three years
- Reform implemented gradually from October 2012
  - large employers first, those with fewer than 250 employees unaffected until March 2014 (or later)
- Minimum contributions
  - eventually 8% of (banded) pay with at least 3% coming from employer
  - minimum employer contribution 1% until October 2016

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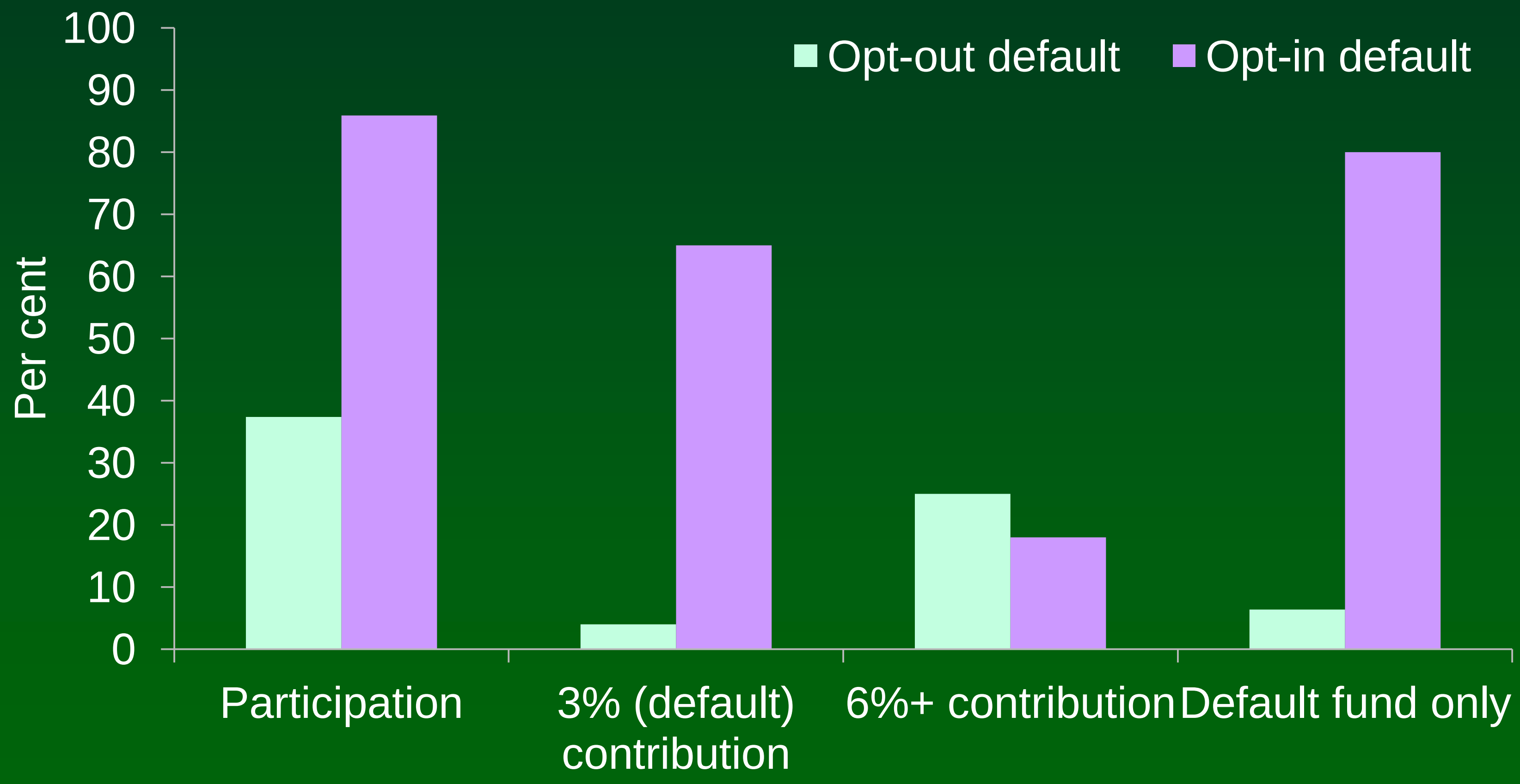
# More to contribute to a private pension, but some might contribute less?

Pensions saving behaviour 3–15 months after hire, single firm
Groups hired just before and just after move to opt-in default




Source: Madrian and Shea (2001).

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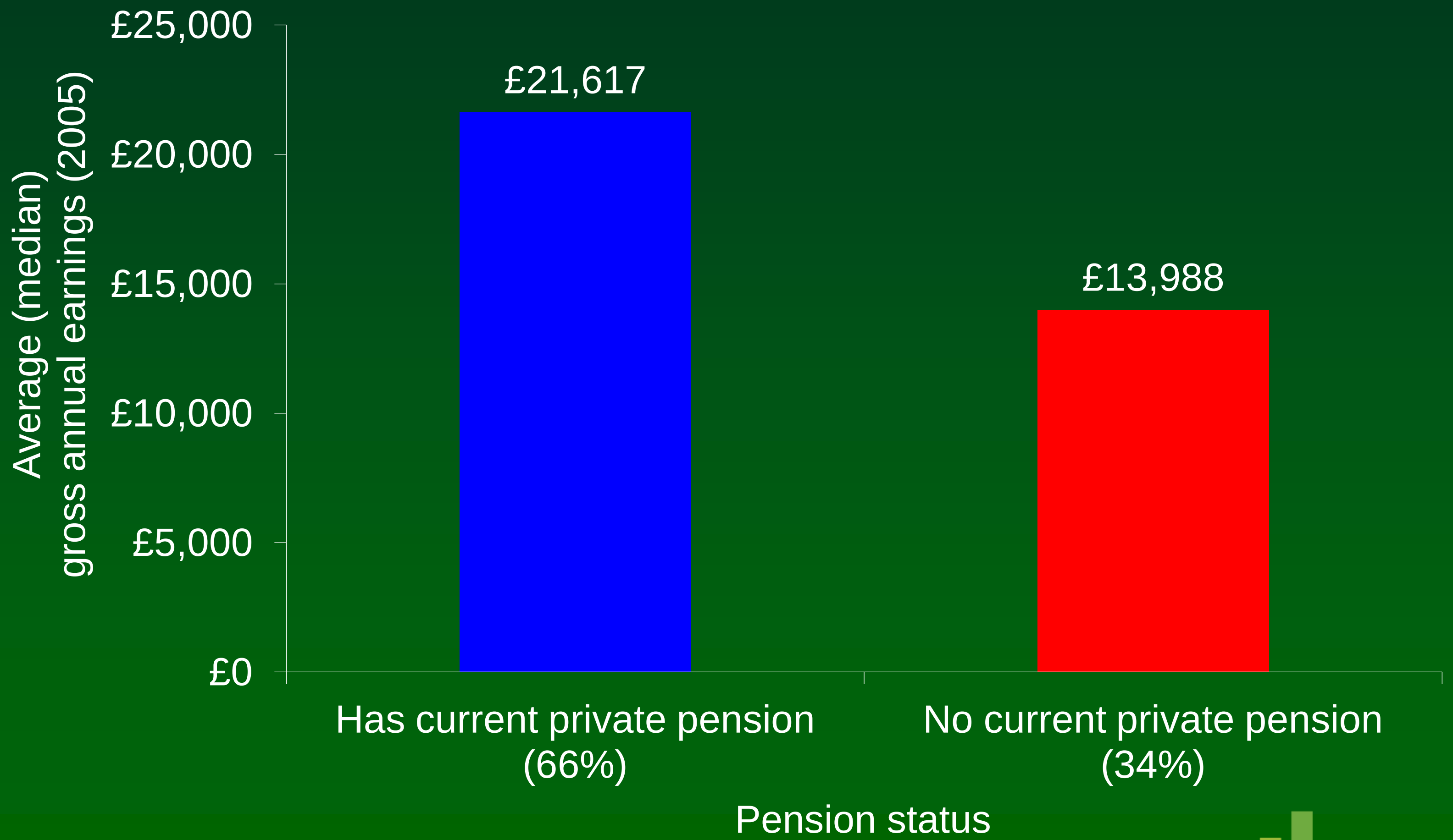
# Pension status and earnings




Source: Emmerson and Wakefield (2009).

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# Pension status and net liquid financial assets


Source: Emmerson and Wakefield (2009).

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# Conclusions

- Public service pensions
- Moving to a flat rate state pension
- Increasing state pension age
- Workplace pension reforms

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# Conclusions

- Public service pensions
  - current schemes are not ‘unaffordable’ as significant cuts to public service pensions already announced
  - latest public service pension reforms do much to improve structure of pensions
  - in some schemes reductions in the long-run generosity for high flyers offset by gains, on average, for those with lower earnings growth
  - public service pensions remain much more generous than those provided in the private sector
- Moving to a flat rate state pension
- Increasing state pension age
- Workplace pension reforms

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# Conclusions

- Public service pensions
- Moving to a flat rate state pension
  - simplicity welcome but losses need to offset gains to keep within stated cost envelope
  - will a simpler system prove more durable?
- Increasing state pension age
- Workplace pension reforms

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# Conclusions

- Public service pensions
- Moving to a flat rate state pension
- Increasing state pension age
  - will help to boost retirement ages
  - biggest losers might be those who would like to work more but are unable to do so
- Workplace pension reforms

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# Conclusions

- Public service pensions
- Moving to a flat rate state pension
- Increasing state pension age
- Workplace pension reforms
  - auto-enrolment into workplace pensions significant
  - likely to boost pension coverage
  - but some might reduce their pension contributions, and should those brought into a pension be saving in that form?

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# Radical pension reforms?

Carl Emmerson

Presentation at “The Future Outlook for UK Pensions: Sustainable and Equitable Pensions for All”, Inside Government conference, London, 13 July 2011

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