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

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Outline

• Public service pensions
• Moving to a flat rate state pension
• Increasing state pension age
• Workplace pension reforms
Spending on public service pensions forecast to fall as a share of national income

Notes and sources: see Figure 5.1 of *The IFS Green Budget: February 2012*. 
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
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
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.
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
“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?
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
Employment rates, by sex and age

Employment rates, by sex and partner’s age

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• Biggest losers might be those who would like to work more but are unable to do so
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
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

Pension status and earnings

Source: Emmerson and Wakefield (2009).
Pension status and net liquid financial assets

Source: Emmerson and Wakefield (2009).
Conclusions

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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

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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
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
Conclusions

• Public service pensions
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• 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?
Radical pension reforms?
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