All-Party Parliamentary Group for Social Science and Policy

Policy for pensions and the credit crunch

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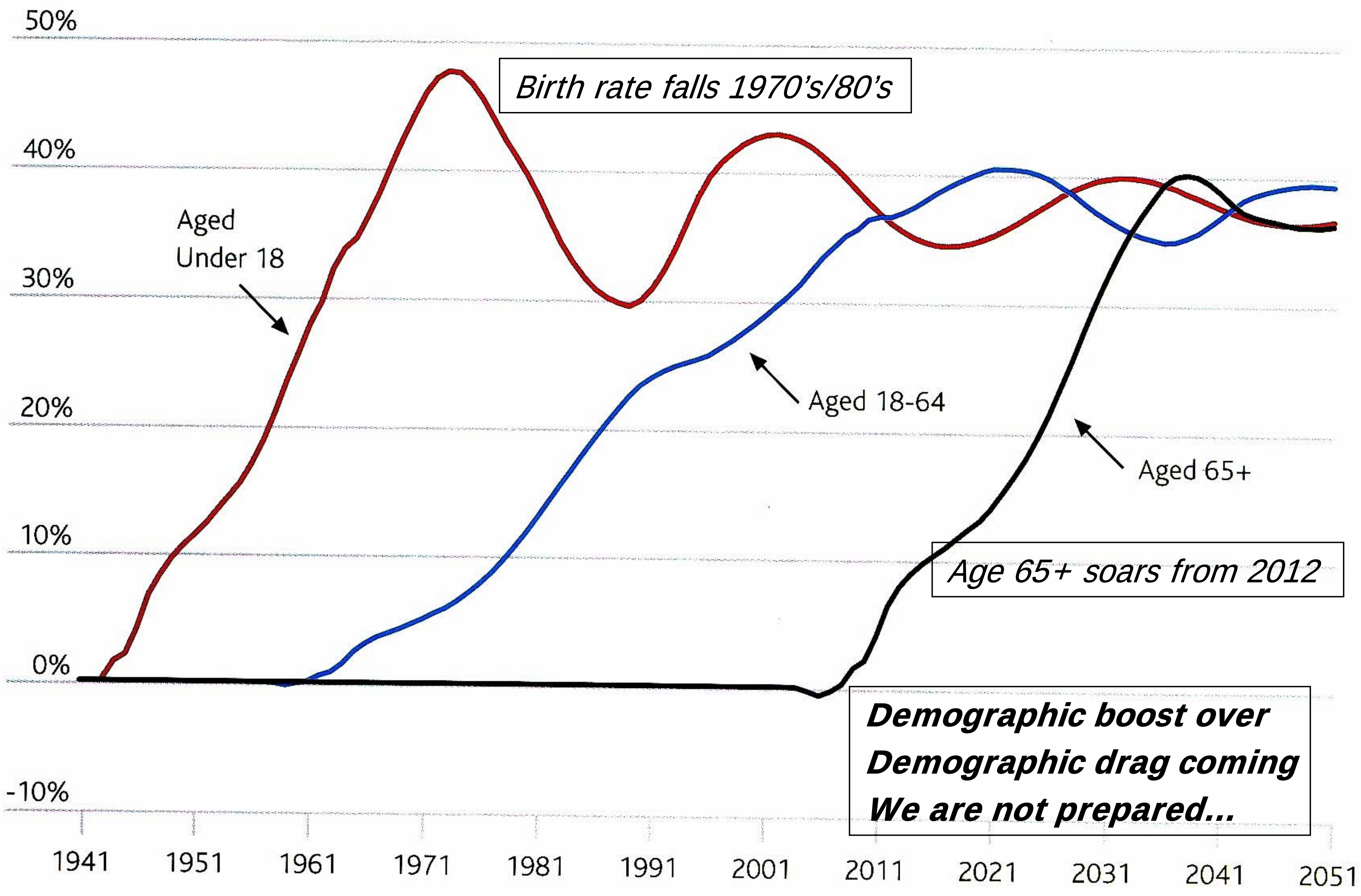
Overview

- Credit crisis
- Policy response
- Pensioners
- Pension Schemes
- Policy proposals summary

Credit Crisis - causes

- Living beyond our means – too much irresponsible borrowing, spending, lending
- Public and private sector debt too high
- Chasing short-term growth and profit – feelgood factor
- Asymmetrical FSA regulation: easy to borrow, hard to save
- Unwinding asset price bubbles in housing, credit, loans...
    - Too little caution on way up, too much on way down
- Savings ratio plummeted – dangerous in ageing population



Source: Pensions Commission analysis based on a synthetic model of the England and Wales population

Policy to bail out banks

- Billions into banks- encourage more lending!
- Panic reaction throw money at the problem
- 100% bailout of IceSave and others – unlimited amounts despite £50,000 cap, including interest!
- Not all can survive – regulation must be tighter
- But is the agenda being driven by the banks?
- They have to rebuild margins and profits, can't lend to all

Bank irresponsibility in perspective

- **What a difference a year makes:**
- Just over one year ago RBS paid $100bn for ABN Amro (80% in cash). For this sum, RBS could today buy:
- Citibank $22.5bn
- Morgan Stanley $10.5bn
- Goldman Sachs $21.0bn
- Merrill Lynch $12.3bn
- Deutsche Bank $13.0bn, and
- Barclays $12.7bn
- **…and still have $8bn change!!! This was all fiction**

New thinking required

- Debt has to be repaid – can’t just rely on growth
- As population ages we can’t keep borrowing from future taxpayers if they aren’t there
- Encourage saving, cut wasteful spending
- Need radical pension reform
  - National insurance is a tax, but top earners pay least
- Pension credit undermines private saving or earnings
- Pensions tax relief is inefficient incentive
  - Leakage abroad, tax arbitrage, tax free cash

Policy proposal

- <u>Spend differently and more fairly</u>

- £30billion spent on pensions tax relief – half to top rate taxpayers, a quarter to top 1% of taxpayers!
- £10bn contracting out rebates
- Administering tax credits, especially pension credit
- Redeploy existing staff and assess real needs

VAT cut in PBR

- Temporary reduction to cost £12bn
  - 2.5% won't really help consumption
  - Deflationary forces don't need further boost in 2009
  - Will be unwound at wrong time too
  - Costs to business in implementation
  - Stealth tax for councils or hidden profit boost

Policy proposal

- <u>Bring back the 10p tax rate</u>

- Cut direct taxes, not indirect taxes
- Help all taxpayers, but especially lowest earners
- Simple to understand
- Rather than ‘compensate’ losers, just unwind error

Dramatic rate cuts not the answer

- Dramatic interest rate cuts to 2% ... and beyond?
  - Problem is availability of credit, not cost
  - Tax increase on savers, cuts pensioners’ income
  - Pushing on a string
  - Damage confidence
  - Japan had rates at zero but no recovery
- Easing monetary policy is scattergun approach
- Pensioners suffer collateral damage

Bad for pensioners

- Cutting rates is not necessarily expansionary
- This is a tax increase on pensioners
- Cutting their income, poverty worse – penalise savers
- Worsens annuity rates
- Unconventional times
- Ageing population

Policy proposal – radical reform

- <u>Pay £140pw pensions to all over 75s</u>

- Cost £2bn a year
- End poverty for the elderly – no take up problems
- Help poorest pensioners spend more
- Fair to women at last
- Cut admin costs and errors
- No annuity requirement

Pension Schemes hit – final salary

- Final chapter for final salary
- Social welfare is not for 21st century employers
  - Only one of the original FTSE 350 still exists!
- Employers struggling with deficits – latest PPF figures
  - November 2008 deficit £136.0 billion
  - October 2008 deficit £97.3 billion
  - November 2007 surplus £26.1 billion
- As schemes close and mature employers want to remove risk but buy-outs or buy-ins more difficult
- Falling markets and interest rates increase problems

Pension Schemes - DC

- Investment returns unreliable – over reliance on equities
- Unrealistic expectations exposed further by credit crisis
- Pension received will depend on
  - Contributions – being cut
  - Investment returns (net of fees) – fallen sharply
  - Annuity rates – will get worse

Policy proposal

- **<u>Issue pension and annuity gilts</u>**
  - Long duration
  - lpi linked (0-2.5%, 0-5%) – not rpi
  - Mortality-longevity linked

- Help to match liabilities
- Improve clarity of outcomes
- Help finance public sector borrowing domestically

Policy recommendations summary

- Bring back 10p tax rate
- Redeploy spending on tax relief, contracting out, admin
  - Use Child Trust Funds for **lifetime** savings accounts
- Increase state pension to £140 a week for all over 75s
- Issue pension gilts and annuity gilts
- Radical rethink of pensions and retirement

Additional slides…

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History: what are 'pensions'?

1. Social welfare (Original state role, no begging in streets)

2. Long-term savings vehicle (Later private role)

- Both are called 'pension', but are not the same – muddled thinking
- 20th Century employer paternalism caused confusion
  - Final salary schemes to look after loyal lifelong workers
  - 1970's/80's industrial restructuring early retirement
- Helped young baby boomers to find work, but led to unrealistic expectations
- Government relied on employers and equity investing to offset UK substantial cuts in UK state pension

Demographic dangers huge

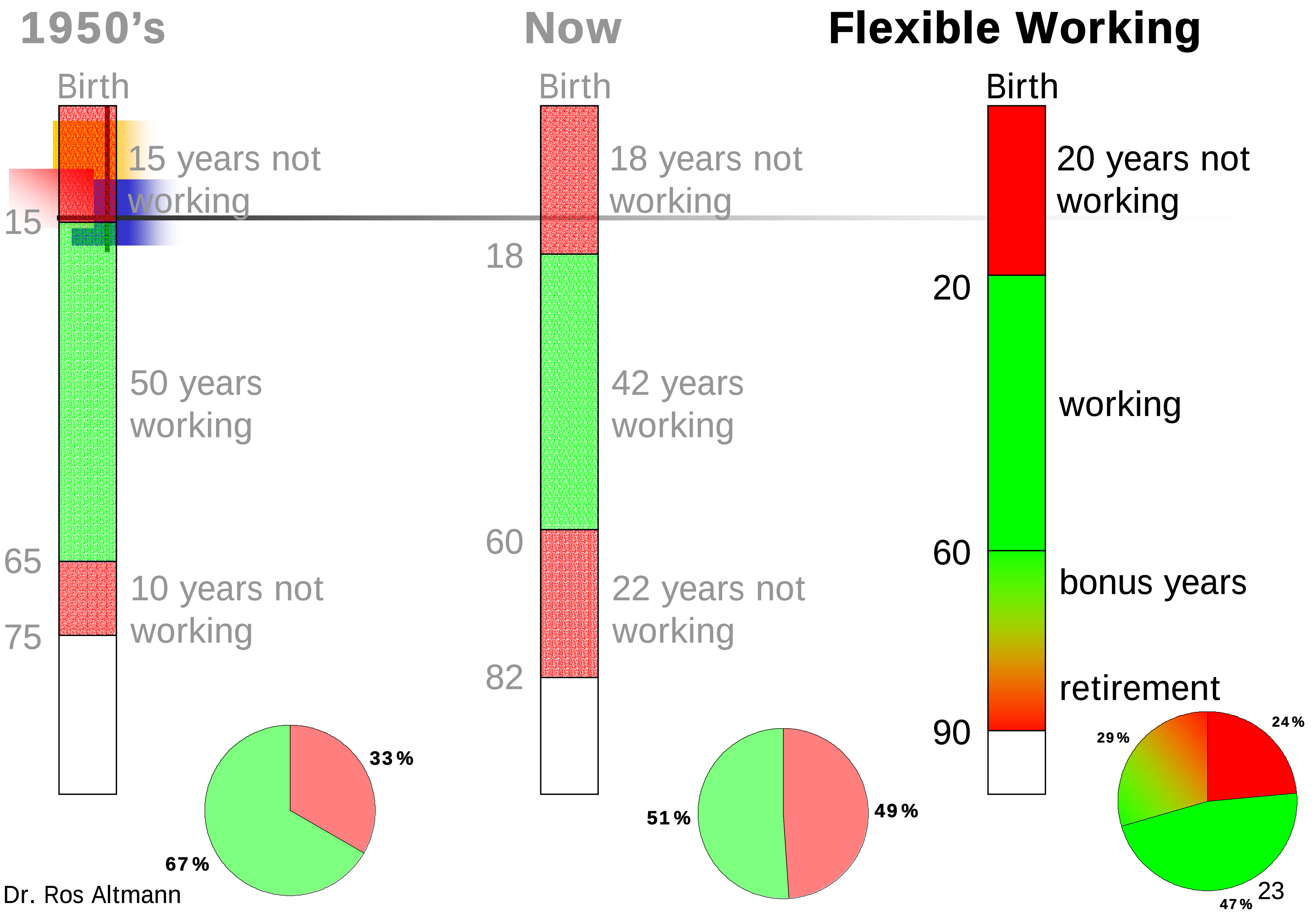
- Official view: no pensions crisis now but may be in future
- Wrong: pensions in crisis now, ***pensioners*** in crisis soon
- Baby boomers now reaching pension age after 2010
- Economy benefited from demographic boost
- Savings were discouraged in the boom times: short-sighted policy
- Heading for demographic drag- huge growth in age 65+

Personal accounts bad for pensions

- Personal accounts- Opportunities
  - **Politicians** can claim lots more people are saving
  - **Government** will save money on means testing
  - **Finance industry** may have more assets to manage
  - **Employers** can cut back to 3% of ‘band earnings’
- Personal accounts- Threats
  - Levelling down: 3% minimum becomes maximum
  - Just replace pension credit: 40-100% tax! Suitability?
  - Generic advice can’t address suitability, investment risk
  - Admin nightmare, small pots to track, annuities?

But are we thinking correctly?

- Getting money in short-term pleases politicians and industry, but getting good pensions long-term is vital!
- This is not just a 'pensions' issue – it's a retirement issue
- Can't sort out pensions without rethinking retirement
- Pensions are trying to last too long
  - Most people can't save for 25-30 year decent pensions
- What a waste of resources!
- Policy lagged behind improved life expectancy, health, working practices



1950's
Now
Flexible Working
Birth
15 years not working
15
50 years working
65
10 years not working
75
33 %
67 %
Birth
18 years not working
18
42 years working
60
22 years not working
82
51 %
49 %
Birth
20 years not working
20
working
60
bonus years
retirement
90
24 %
29 %
47 %
23
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Pensions alone can't solve the **pensioners** crisis

- New phase of life waiting to be enjoyed – 'bonus years'
  - 2-3 days working, 4-5 days off, sabbaticals, retraining
- Cut down gradually- part-time working, job sharing
  - Precedent: working mums with young kids
- More leisure and more money to enjoy the leisure
- Better for individuals, employers and the economy
- This is the employer role in 21st century
  - Age discrimination should not stop at 65