

Pensions  
Commission

## The UK Pensions Challenge

Chris Dobson  
Pensions Commission Secretariat

[www.pensionscommission.org.uk](http://www.pensionscommission.org.uk)

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- **Introduction**
- The Demographic Challenge
- Trends in state and private provision
- Are people saving enough?
- Conclusion: 4 options for society

## The Pensions Commission

Independent body with remit to make recommendations to the Secretary of State for Work and Pensions

Terms of reference:

- “to keep under review the regime for UK private pensions and long-term savings, and to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach.”

*Simplicity, Security and Choice: Working and Saving for Retirement*, DWP Green Paper, December 2002

## Very brief overview of the UK pensions system

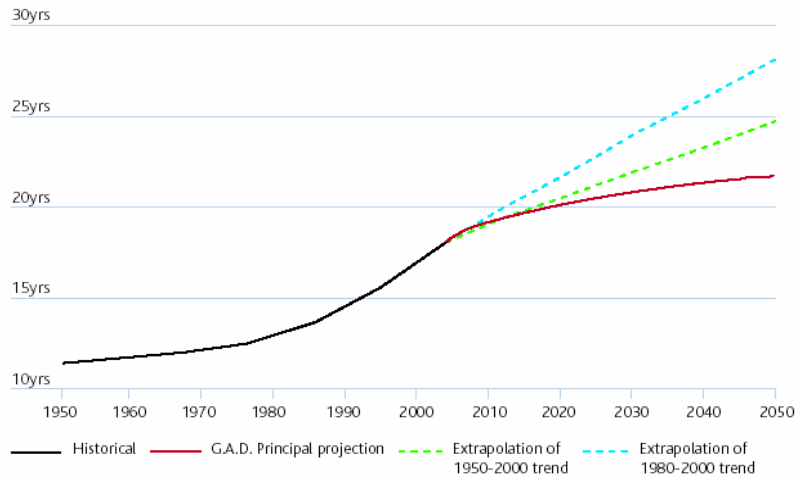
- State pensions
  - Basic State Pension (flat rate, 16% of average earnings)
  - State Second Pension (earnings-related, within limits)
  - Means-tested Benefits (income top-ups)
- Private pensions
  - Occupational (defined benefit or defined contribution)
  - Personal (defined contribution)
  - Can 'contract-out' of state second pension into private pension
- The UK pension system is “the most complex in the world” and rules have changed frequently

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# Life expectancy has increased and could continue to increase: the question is by how much?

## Cohort life expectancy at 65



Source: Pensions Commission analysis 1950-1970 based on GAD historical data, England and Wales  
 GAD historical data 1960-2002, UK  
 GAD 2002-based principal population projection, UK, from 2003 onwards

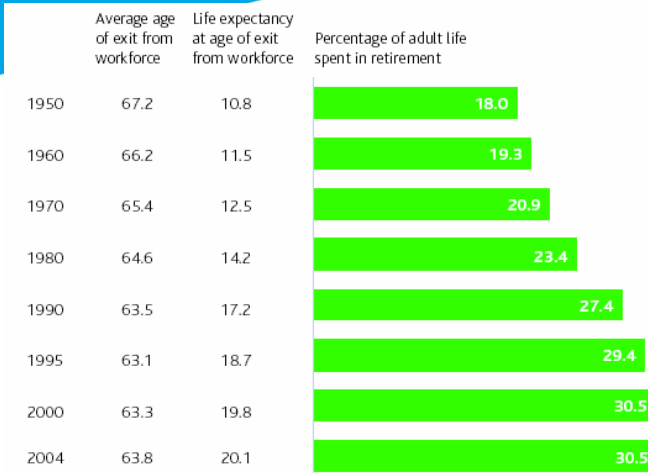
..Although the evidence on healthy ageing is not comprehensive it would seem people are living longer and are healthier for longer.

## Health status of US over 65 population



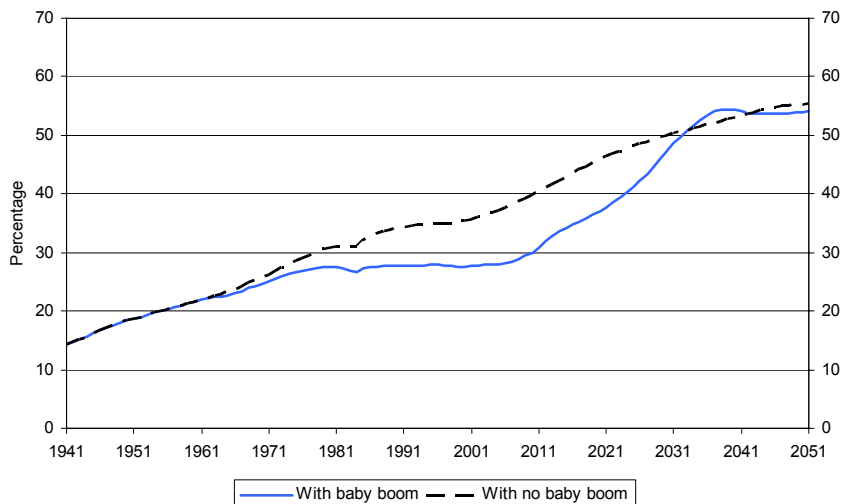
Source: National Long Term Care Surveys, 1982-1999, US. Manton and Gu (2001), Copyright 2001 National Academy of Sciences, USA.

As life expectancy has increased, the average age of retirement has declined and the percentage of adult life spent in retirement has increased significantly...



Source: Blöndal and Scarpetta (1999)  
Pensions Commission estimates from 1990 onwards.

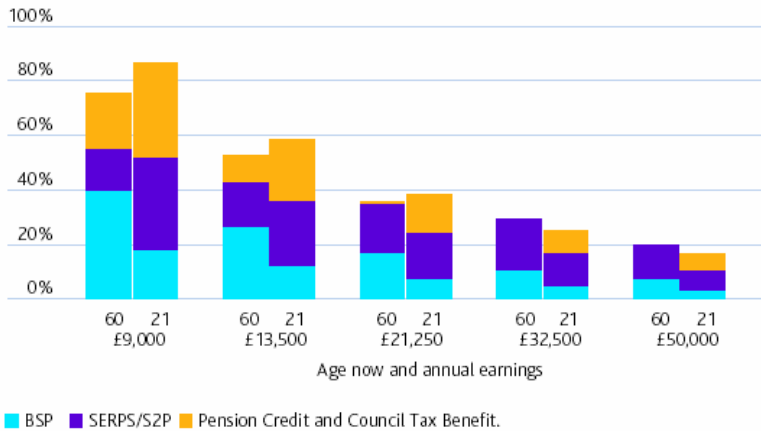
The dependency ratio will inevitably rise. The baby boom has disguised this up to now and over the next 30 years we will see a rapid increase in the dependency ratio as we catch up.



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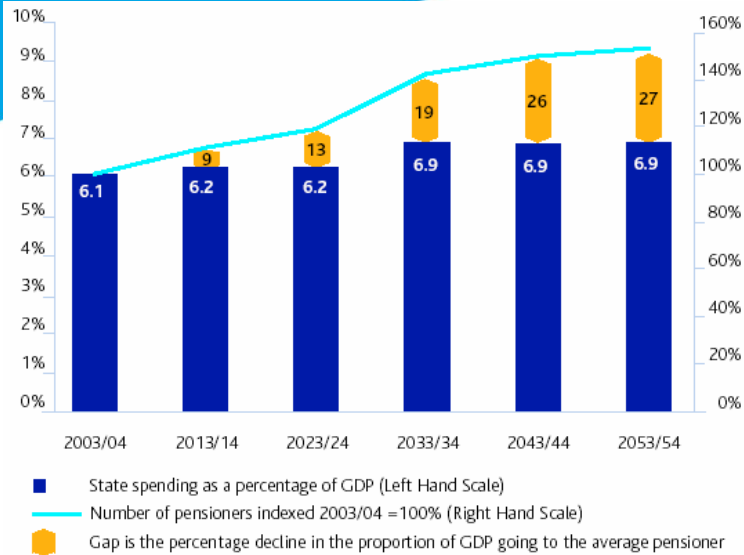
Over time, state pensions are becoming less generous for all but the poorest



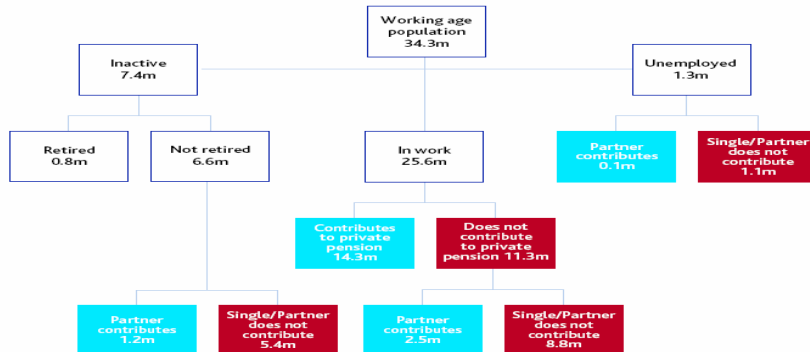
Source: DWP and Pensions Commission analysis

Note: Assuming 44 year working life for SERPS/S2P.

## Current expenditure plans would mean the increase in number of pensioners is greater than increases in state spending...



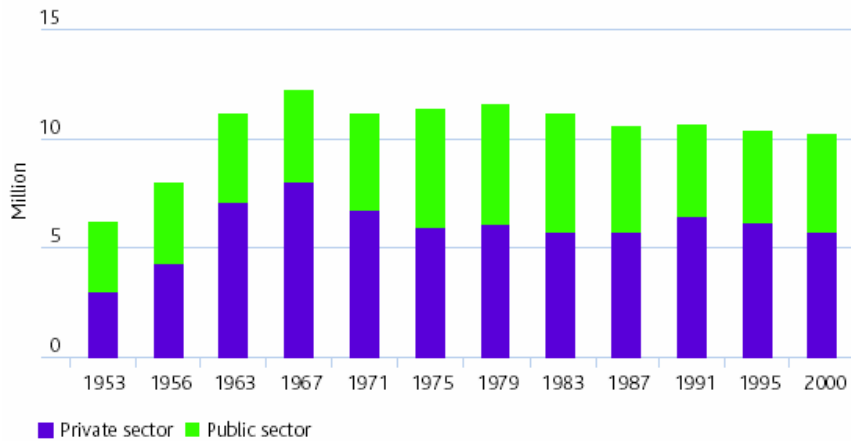
## About half of people in work participate in private pensions



Source: FRS, 2002-03

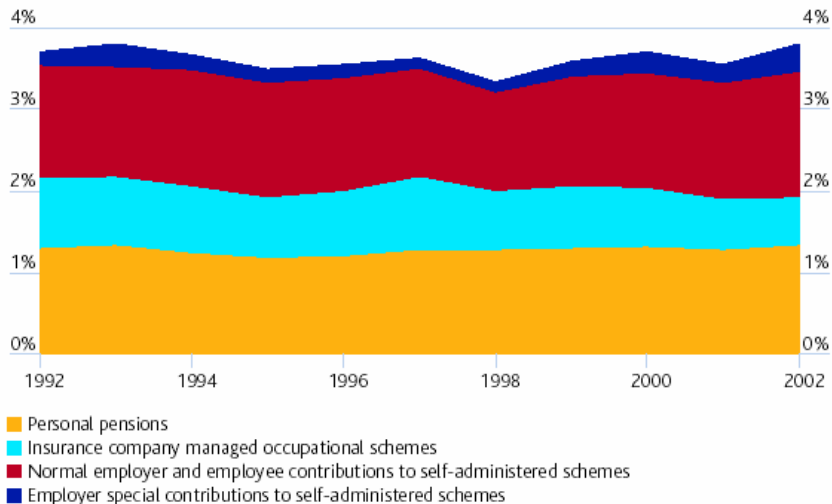
Note: Those individuals with personal pensions that are only receiving contracted-out rebates have been counted among non-contributors since they will only accrue pension rights equivalent in value to the SERPS/S2P rights foregone (assuming that GAD calculations of appropriate rebates are fair). As the numbers of inactive and unemployed individuals contributing to Stakeholder Pensions are small (fewer than 0.1m in FRS) they have been ignored for the purposes of this analysis. Figures may not sum due to rounding.

Membership of occupational pension schemes in the private sector has been in long term decline since the 1960s.

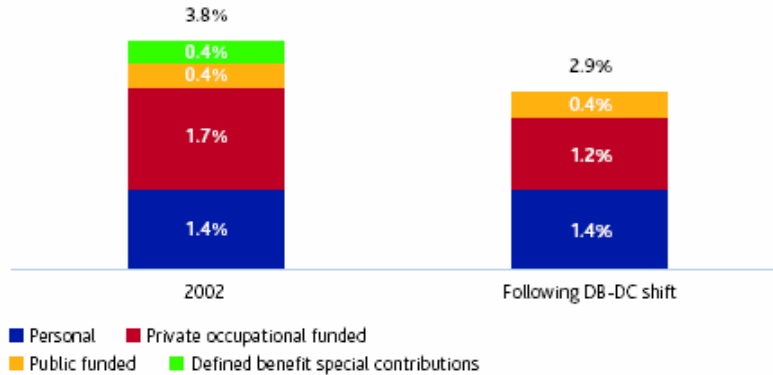


Source: Occupational pension schemes 2000, GAD

Contributions to funded pension schemes have remained relatively stable over the last decade

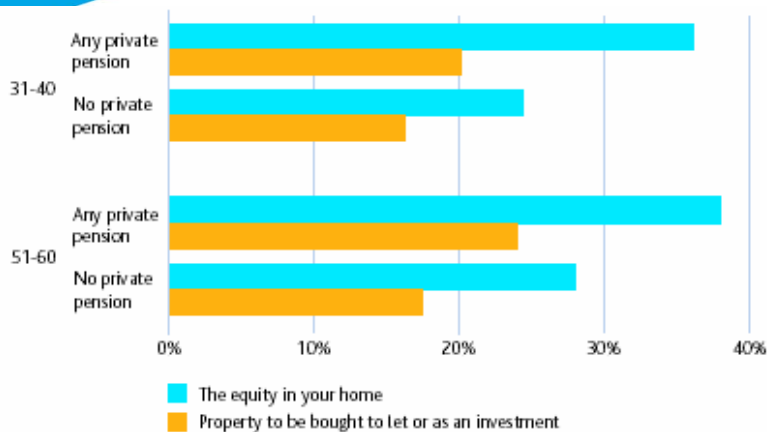


If DB and DC contributions remain at current levels then the DB-DC shift leads to falling pension contributions as percent GDP



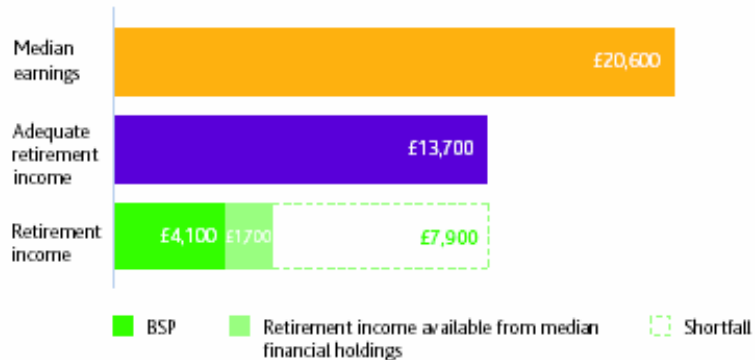
Source: Pensions Commission Estimates

Significant numbers of people are thinking about using resources from property in retirement, but these people tend to be those who have a pension



Source: NCPWorld Financial Research Survey, July 2003-May 2004

For someone on median earnings with median levels of financial holdings there is a significant shortfall from an adequate income

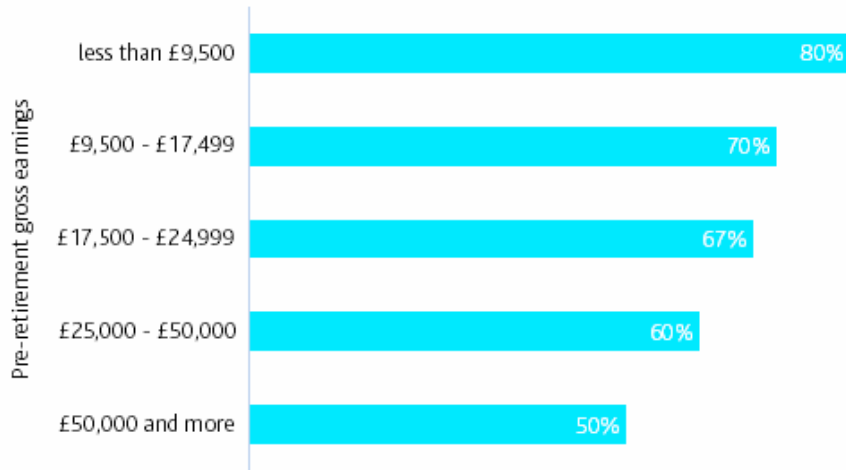


Source: NES, 2003, GB and Pensions Commission Analysis

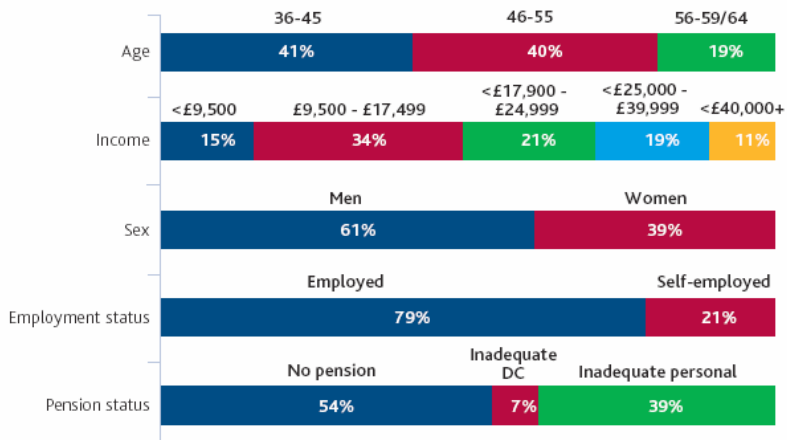
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To assess the scale of under saving the Pensions Commission assumed a sliding scale of target replacement rates.

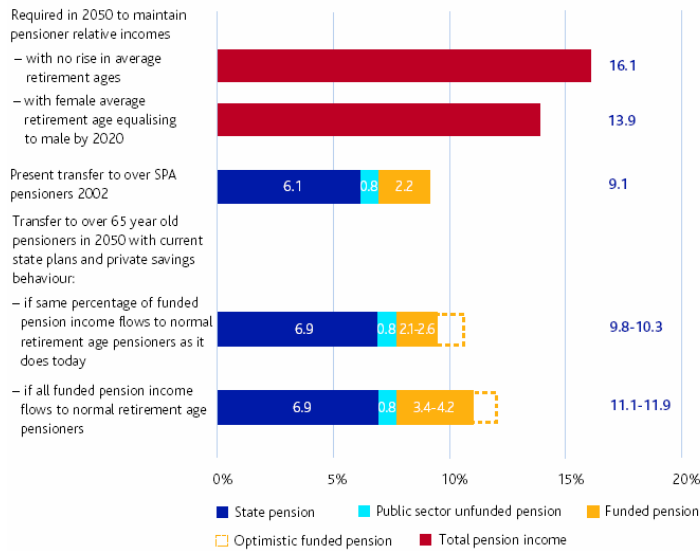


9.6 million people are under saving. This is sensitive to assumptions, but the story is not.



Source: Pensions Commission analysis based on FRS 2002/3, NES, GAD and Inland Revenue data

## For society there is a gap between what is needed to maintain living standards and what savings will produce



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## Conclusions

- The demographic challenge means society will need to transfer an increasing share of GNP to pensioners to maintain their incomes
- But trends in private and state provision suggest this is not happening
- There are also significant inequities in UK pensions – because of the pension system and the labour market
- There are only four options

## Barriers to a voluntarist solution

- Inherent barriers to effective pension markets
  - Behavioural economics
  - Psychology
- Specific UK barriers
  - Complexity and lack of trust
  - The impact of high selling and administration costs
  - The impact of means-testing

Society must choose between these four options. There are no alternatives.

- Pensioners poorer relative to average incomes
- Higher taxes/NI contributions devoted to pensioners
- Higher funded pension savings
- Higher average retirement ages

Society must choose between these four options. There are no other options.

- Pensioners poorer relative to average incomes
  - Pensioners poorer by 30% relative to today
- Higher taxes/NI contributions devoted to pensioners
  - Increase basic rate of income tax by 16 percentage points
- Higher funded pension savings
  - Triple the amount of private pension saving
- Higher average retirement ages
  - Increase average retirement age from 63.8 to about 70

