

Pensions Scenario

Looming Disaster for future generations?

State Pension values by country.

UK State Pensions historical value and future trends.

Regional pensions.

Impact of local taxation (Council Tax)

Condition of private pensions revision.

Impact of means-testing.

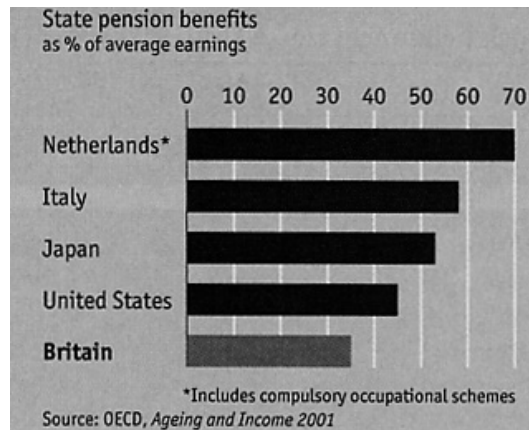
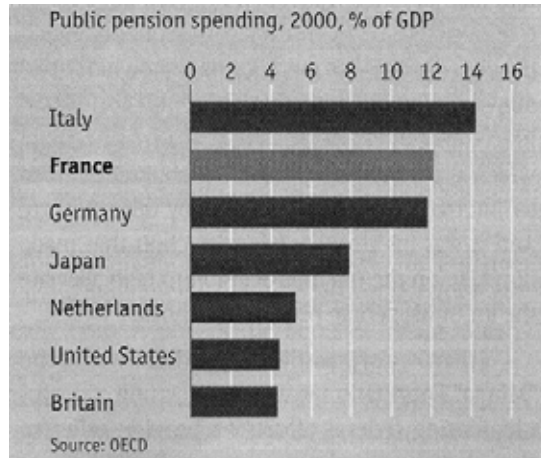
Unfunded means tested benefits compared with the funded State Pension.

Depth of the poverty trap.

The National Pension Pot now used to support general taxation.

Although today's pensioners have valid concerns, feel aggrieved, and, some suffer hardship, it is likely that the pensioners of tomorrow will have it even worse.

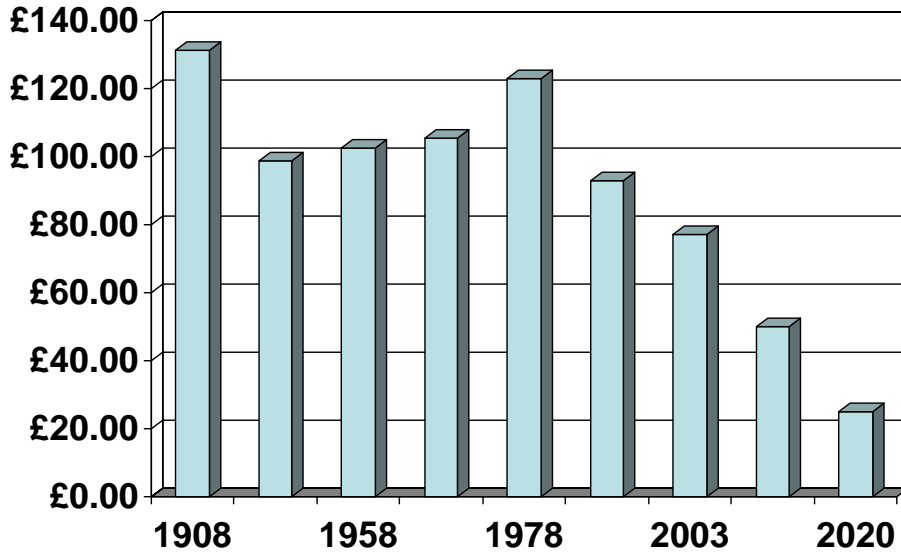
To fund its State Pension Britain spends a smaller proportion of its National Income than any other developed country. Even the United States, notorious for its low social spending, spends more. Given this, it is hardly surprising that Britain's State Pension (as a percentage of average National Income) is also the lowest in the developed world as is shown.



Furthermore, the State Pensions are reducing. Bismarck thought State Pensions a good idea in the 1880's. Britain introduced them in 1908. They started at 25% of average income which is equivalent to just over £130 per week today. They gradually reduced to their present level of £77 and, by 2020 the State Pension will be the equivalent of around £20 per week. This is illustrated on the next graph. Future pensioners could therefore be worse off. In 1981, the government cut the link between increasing pensions and increasing earnings. Pensions increase by RPIX (inflation rate excluding mortgages) measured in September – the lowest inflation month of the year! RPIX does not reflect actual pensioners' costs. For example, Council Tax which increased massively since 1997 swamped the pension increases.

State pensions increase at the same rate nationally but Council Tax varies widely – ours increased by 70% in six years. The Scottish Parliament allowed more generous support for elderly care. Thanks to the Barnett Formula they can afford it so, English pensioners look enviously across the border whilst English

Weekly State Pension (2003 values)



taxpayers pick up the bill for Scottish Parliament's largesse. Should State Pension values vary across the UK? In Moscow, funded by local taxation, the City Mayor tops up the pension to reflect the higher costs in that city. Should the same apply to the South East? In the South many pensioners have to dip into their savings to pay Council Tax. Why are pensions centralised whilst pensioners' benefits are devolved? Why do Local Authorities control only 3.5% of the public spend? This too is the lowest in the developed world.

In the early 90's Britain's private pension savings were the highest in Europe, this suited governments who wanted to shift the burden from public to private. However, government has erected obstacles against private pensions and over the last few years people lost confidence in them.

When a new Government was elected in 1997 many had high expectations. However, the Chancellor taxed private pensions by £5 billion per year. At first, most savers did not appreciate the significance of this massive tax hike. The government basked in the reflected glory of a booming stock market (although it was little to do with them) and this masked the effect. The boom ceased then reversed and this, plus the tax, put many private pensions into deficit. Currently, there is a £160 billion black hole in pension funds. This is so high it will affect the National Economy, reducing economic growth and tax revenues so forcing the government to recognise the pensions crisis. What else has happened?

Since 1997, there have been a series of shocks within the Financial Services industry. Around 700,000 policy holders lost at least 25% of their pensions because of mis-management at Equitable Life. According to the FT, the government regulator could have acted 10 years before the problem arose. Workers who had put money all their working lives into their company pension scheme found themselves poverty stricken overnight when their company went bankrupt. Some people found that on the very day of their retirement they had no private pension. Savers realised that pension policies were the only form of saving where guarantees seemed meaningless, and furthermore, were shocked to appreciate the money was inaccessible to them for decades and this discourages pensions saving. The best private pensions were 'Final Salary' schemes which are declining. More and more savers must use Money Purchase Schemes which are more risky. Money Purchase Schemes mean buying an annuity at retirement which is

complex and inflexible because of tax and other government regulation. An attempt to reform annuity regulations failed due to lack of government support on July 11th.

Employment is now unpredictable. Gone are the days when a person could count on long-term employment in the same company, so, many workers leave a trail of pension pots behind them as they have to move from job to job. It is a real problem keeping track of them and the tax complications can be baffling. Public employees have extremely good pensions compared with those in private employment. All this makes private pensions unattractive which discourages saving for retirement. Reasons include the complex legislation and tax rules (especially on annuities) and the extra tax burden introduced in 1997. Retired private pension-holders face complex tax returns with multiple errors made by Inland Revenue. There are other government implemented deterrents. Means-testing is probably the worst.

To get more 'bangs-per-buck' government focussed paying a minimum income guarantee (MIG) to pensioners who have demonstrated they are poor by subjecting themselves to a complicated sometimes humiliating appraisal of their confidential affairs. One consequence is that of the 5.5 million pensioners eligible for means tested benefits 1.8 million do not claim and remain in poverty. For the new tax credits the government only sets a 25% take up target. Means testing is also expensive to administrate but no-one has come clean about the costs.

There are other insidious consequences. Means testing encourages dishonesty prompting people to conceal their assets. MIG is a 'Gateway Benefit' qualifying the recipient for other benefits such as Housing, Council Tax and medical costs. Its effects equate to a very large rise in income. Typically, means-tested benefits apply to those with less than £16,000 in savings. To get the same level of effective income achieved by means testing the recipient would need *more* than £16,000. How much more? £42,000 (according to Frank Field) or, £85,000 (according to David Willetts). This discourages pensions-savings. Two reactions are shown below. The message is "Why bother to save?"



Let's take the midpoint of £63,000 between the estimates of Frank Field and David Willetts. Means-testing philosophy says "if you have less than £16,000 we will increase your equivalent wealth to £63,000" This is a classic poverty trap, how deep is the trap? Is it £47,000 deep (£63,000 minus £16,000) Imagine how this looks and feels to someone who saved £60,000, £40,000 or £20,000.



Many would think that £63,000 is an amount of money quite beyond their reach, but, the trap might be much deeper. It is demonstrable that full means-tested benefits are equivalent to an income of £12,000 to £14,000 per year – let's say £230 per week (over 3 times the State Pension) Sourced from an annuity such a pension requires over £200,000. This is more than 4 times the average size of an annuity fund. Is the trap therefore £184,000 deep?

We should of course, support those who need it through no fault of their own. If however, such support is 3 times the State Pension it discourages saving and even working. MIG related benefits increase at a faster rate than State Pensions, so, the gap between the State Pension and the MIG grows, attracting more to means-tested benefits. Will this growth make MIG unaffordable? Should the wealth qualification be triggered at £63,000 or even £184,000? Does it make more sense (and cost less) to raise the State Pension to the same level as MIG? Disincentive also results from when pensioners losing tax allowances if private pensions increase their income to over £18,300 per year (only 76% of national average wage). The forthcoming tax credits replacing MIG is the same thing but made even more complex.

People over 50 can get a State Pension forecast from the National Pension Service via form BR19. Entitlement is based upon National Insurance (NI) contribution years. The National Pension Service makes errors. It is advisable to keep one's own employment records and check their forecasts. People in continual employment who calculate their NI contributions over their working lives are often shocked by the huge amounts they have paid. To qualify for a full pension a man needs 49 years and a woman needs 44 years (women's contributions are gradually being increased to equal men's) National Insurance was set up to cover Social Security benefits including the State Pension. It was literally an insurance system not a tax system. However, this year the government raised the National Insurance contributions. The increase is not for pensions – it goes into the general taxation pot. This sounds rather like Robert Maxwell.

Many people have noted the massive pension entitlements of certain public figures such as Lord Irvine (the former Lord Chancellor). It is ironic that the government and their MP's (whilst saying "Crisis – what pensions crisis?") vote themselves big secure pensions indirectly subsidised by the taxpayer. Meanwhile, unless government action is taken the young people of today and all those not yet retired face a miserable future when they do. Oliver Cromwell is reputed to have said "*If you always do what you always did, you'll always get what you always got*". The longer we carry on doing what we've been doing the more urgent and drastic will be the need to act.

Something must be done.