

SPEECH FOR PRESS CONFERENCE

Check against delivery

Good morning, and welcome to this launch of the second report of the Pensions Commission.

Some general comments to begin.

First the report is a unanimous one, and indeed does not reflect a process of difficult negotiation in order to arrive at that unanimity. That is in part because detailed analysis of the UK's pensions system makes many conclusions unavoidable.

Secondly while we illustrate specific possible ways forward, with dates and figures, we recognize quite explicitly throughout the report, that some of the precise recommendations depend on balanced judgments and tradeoffs between different desirable objectives, and that there are difficult issues of affordability which will determine the timing of feasible reform.

Third therefore the aim of this report is to stimulate a rational debate about those tradeoffs, rather than to define a precise way forward.

But fourth, we are confident that a feasible and sustainable way forward exists. There are significant problems in our pension system, there is a major demographic challenge. But the problems can be overcome with an appropriate and integrated set of policy responses. People are living longer. That is a marvelous development which will only become a problem if we fail to think through the policy responses required.

The Report starts with a description of the current situation, confirming and developing First Report findings [Slide one]. Key points are

- That the state is planning to play a diminishing role in pension provision for the average earner.
- That both this government and the previous government have proposed that private pension provision should grow to fill the gap left by a declining state role.
- But that private pension provision, far from growing, is in underlying decline. Employers have a declining interest in providing pensions for self interested reasons: personal purchase of pensions is not growing: and the most dynamic element in private pension saving, special contributions to plug pension deficits inherited from the past, does not create new pension rights for the future.

[Slide 2] Despite those trends, however, it is still reasonable to question some conventional assumptions.

- Is there a crisis; is there a “savings gap”?
- And if this is a problem for the future, can we not wait until the future to deal with it?

It is crucial to answer those questions in a way which avoids both unnecessary scaremongering and unjustified complacency.

Four points:

- First today's pensioners are on average better off relative to average earnings than in the past, and that has implications for appropriate policy. But that situation reflects two factors which will pass: 1) the peak generosity of the SERPS system, and 2) the fact that many people are retiring today with more generous defined benefit promises than ever before, Defined Benefit promises which will be enjoyed by far fewer people in future. Looking forward, private pension income is likely to decline as a share of national income, despite a rising number of pensioners.
- Second, beware averages. Within the state system past contributory arrangements have left major inherited gaps in provision for people with interrupted paid work records and caring responsibilities, in particular women. And private and occupational pension provision is very unequal, even between people of the same income level] and becoming more so. Private sector employees lucky enough to be still in salary-related schemes enjoy pension provision typically twice as generous as new employees in Defined Contribution schemes: public sector employees are similarly well placed. Conversely employees of average earnings and below, working for medium and small companies, are on average poorly provided.
- Third point, non pension saving and in particular housing are important. This Report explicitly recognizes that some people will secure retirement income through house purchase and sale, or via inheritance and this has implications for the appropriate design of pension policy, since pension savings rates should reflect the diversity of individual circumstances and preferences. But we also spell out why housing cannot be a sufficient answer for all people.

- Fourth. The importance of long lead times in pension policy. State pension income in say 2030, will reflect accrual rules in place today. Private pension income will reflect today's pension saving, which is affected by today's perceptions of incentives to save, and by people's ability to understand what the state will in future provide and to trust the promise made.

All of which says: there is not a general current crisis of pensioner income, nor a quantifiable "savings gap", but there are significant problems and these will get much worse if policy does not change.

[Slide 3]. These problems moreover will not solve themselves, with inherent barriers to a purely free market solution.

- Behavioural barriers to people making rational long-term savings decisions without encouragement and advice.
- High cost barriers to selling pensions profitably to employees of small and medium enterprises.
- Declining interest among employers in providing pensions for self interested recruitment and retention reasons.
- Barriers created by complexity and by expectations that means testing would spread if current indexation arrangements continued indefinitely.

[Slide 4]. Given that analysis we believe that we need a new pension settlement with two key elements.

- A National Pension Savings Scheme (NPSS) which will encourage and enable all people to save for a pension at low cost.

- And policies which over time will make state pension provision more generous and less means tested, but with the state pension age rising gradually as life expectancy increases.

[Slide 5] Key features of the National Pensions Saving Scheme include

- Auto enrolment, either into existing high quality employer schemes or into the NPSS, but with the right to opt out. This uses the power of inertia to encourage people to save, but leaves individuals ultimately free to make their own decisions.
- A suggested minimum default employee contribution rate of 5% of pretax earnings above around £5000 and below around £33,000 of which 1% is effectively paid for by tax relief and thus 4% by the employees themselves.
- A modest compulsory matching employer contribution of 3% of that income band, if the individual stays enrolled. This matching contribution will increase participation rates, and along with measures to reduce the spread of means-testing, will make saving clearly beneficial, thus making possible the elimination of expensive individual advice. But at 3%, its impact on total labour costs will be small, about 0.6% across the private sector.
- Contributions collected via payroll deduction, and paid to a national account maintenance system which bulk buys fund management services at low cost.
 - Thus making possible annual costs of around 0.3% of funds

- Which means that individuals achieve pensions about 30% bigger than if they had to pay the charges of, say, 1.3% typical for personal pensions today.
- But with the money held in individual accounts, which are the property right of the individual, part of their inherited estate if they die before retirement, and with individuals free to choose their investment fund, though with a default fund for those who make no selection.

Other possible details of the scheme are discussed in Chapter 10: the age of first enrollment, how the money collection process should work, the design of the default fund. We have analyzed those issues in sufficient detail to ensure that there are no insurmountable barriers to implementation, and we make tentative recommendations. Those details should however be subject to further consideration and wide consultation.

[Slide 6]. Turning to the state system, the context for discussion has to be the demographic trends.

Life expectancy is increasing, and will continue to increase, but we do not know precisely how fast. Over the last 25 years for instance, official estimates of life expectancy for a 65 year old woman in 2050 have increased from 19 years to 26 years, an increase of around 40%.

[Slide 7]. Those life expectancy increases, along with the retirement of the baby boom, mean that if the state pension age stays at 65 after 2020 the ratio of those receiving state pensions to those aged 20 to 64 will increase by about 75% between now and 2050.

If life expectancy increases were the only factor at work, that ratio would have increased gradually from 1970 onwards. Because of the baby boom, the actual

ratio was kept below the long-term trend between 1970 and today, enabling us to ignore the underlying challenge. Looking forward the increase will be rapid.

[Slide 8] Given those demographic facts, some mix of four things must inevitably happen.

Either the poorest pensioners will become poorer relative to average earnings. Or we can accept a relentlessly more means tested system. Or public expenditure on pensions must rise as a percent of national income or the state pension age must rise

We can disagree on what the balance should be, but this choice is unavoidable mathematical fact.

The Pensions Commission believes that declining relative income for the poorest pensioners is not acceptable. But we also believe that growth of means testing would undermine private savings.

We are therefore convinced that a state system which is fair to all and a sound basis on which private pension saving can build, will require some mix of higher public expenditure as a percent of GDP and a rise in state pension ages.

[Slide 9] The range we suggest for debate is shown in this figure.

- Over the next fifteen years, we do not believe a major increase in public expenditure as a percent of GDP is needed to build a more coherent system, and much of the benefit of increased spending would flow to better off pensioners.
- But over that period, we could improve the generosity of the basic state pension and stop the spread of means testing within a flat percentage of

GDP devoted to pensions, because of the expenditure savings which will flow from the increase in women's state pension age to 65 in 2020.

- Between 2020 and 2045, however, an increase in both pension expenditure and SPA will be needed to ensure an adequate system.
- While beyond 2050 we do not believe it appropriate that future generations should face an ever increasing burden of taxation or contributions.

The long-term range we suggest for debate is 7.5% to 8% of GDP. But to afford an adequate and largely non means tested state pension within that level, would require the state pension age to rise gradually after 2020 reaching at least 67 by 2050. The trade-off must reflect a point of view on equity between generations, on the economic impact of increased taxes, and on the importance of pensions relative to other public expenditure priorities. Different people will make different judgments on that trade-off. But unless people are willing to discuss it, they are not serious participants in this debate. They are indulging in fairy tale economics – in which a fairy godmother makes all difficult choices disappear.

[Slide 10] But let's be clear what we are not saying on the state pension age. Some submissions to us argued that the state pension age must rise rapidly, for instance to 70 by 2030. We do not believe that that is necessary or desirable.

Instead we propose the principle that state pension age should rise gradually so as to keep stable over the long term the proportion of adult life spent paying into and receiving state pensions.

An average man age 65 can today expect to spend 19 years in receipt of the state pension, about 29% of his adult life. If in 2050 the SPA was 67, the best expectation is that the average man would then enjoy three more years receiving

a state pension, 22 years rather than 19 years and a higher percentage of adult life spent receiving a state pension, 31% not 29%. Even if the SPA rose to 69, the actual number of years receiving a state pension would be slightly higher than today, twenty not nineteen.

And even at 69 and even more so at 67, the proportion of people who at least survive to the age at which they receive a state pension, would be higher than it is today, and that is true for Scotland, Wales and Northern Ireland, as well as for England. The figures are in the packs. There are important inequalities of life expectancy by socio-economic class, and we discuss in Chapter 8 policies to help respond to that fact, but all classes and regions can enjoy longer retirements, even as pension ages rise.

Because we are living longer, we can in future enjoy longer retirement than today, but we need to divide the extra years of life in a sustainable balance between some more years of work and some more years of retirement.

[Slide 11] Our recommendation is therefore that the state pension should become more generous and less means-tested than it would if current indexation arrangements continued indefinitely, accepting that in the long term this means somewhat higher public pension spend as a percentage of GDP, and a higher state pension age.

A more generous state pension in the long term at a later age.

There are two alternative ways to achieve this and to create a system which is fairer to people with interrupted paid work records and caring responsibilities.

One is the big bang approach, moving rapidly to a single unified higher value state pension – what some people call a Citizens Pension. The other is to evolve from the present two tiers of Basic State Pension and State Second Pension –

but to accelerate the evolution of that system towards a flat rate and more easily understandable structure.

The objectives of those two routes are the same, and we have analyzed carefully and debated at length the relative merits of those two approaches.

Our conclusion has however been in favour of the evolutionary approach. For 4 key reasons

- First because we cannot move rapidly to the radical option without either high fiscal cost or some undesirable, distributional effects, the maths of which are explained in Chapter 6.
- Second because the radical option, while undoubtedly simpler once achieved, is more complex in transition, illustrating that if you start from a bewilderingly complex system, there is no easy way to the promised land of simplicity without passing through additional complexity on route.
- Third, the fact that the evolutionary two tier route allows a flexible approach to the choice between a universal residency based and a contributory system.
- Fourth, the desirability of preserving good existing employer pension provision, which argues for a gradual phase out rather than immediate abolition of the contracting-out rebate on which we have put in the pack a more detailed description of our proposed approach than included in the Executive Summary. And the desirability of proving the success of the NPSS before abandoning any earnings-related element in the state system.

[Slide 12]. Our preferred option for the state system is set out on Figure Ex 8 of the Executive Summary. Key features are

- Accelerating the evolution of the State Second Pension to a flat rate pension, the S2P becoming a system which could deliver at retirement a pension of £53 per week in current earnings terms, for someone with a fairly full contribution record.
- Indexing the BSP to earnings from some date, though with timing clearly having to reflect issues of affordability within the context of overall public finances.
- Preserving a role for Pension Credit , as an essential targeted tool to prevent poverty, but limiting the future spread of means testing by freezing the maximum real value of the Savings Credit
- Making future accrual of BSP rights universal i.e based on residency, while leaving the S2P as a contributory system, but with improved treatment for carers.

Compared with current public expenditure of 6.2% of GDP (about £77 billion), and if the indexation of the BSP to earnings started in 2010, this package would add annual cost of just over 0.1% of GDP by 2020, about £1.5 billion per year in current earnings terms. If indexation started a few years later, an option we consider in Chapter 6, there would be no increase over the current level as a percentage of GDP before 2020.

The cost relative to what public expenditure might otherwise be of course depends on the indexation arrangements you assume for the base case. On current indexation arrangements, expenditure as a percentage GDP will fall between 2010 to 2020 to about 5.9% of GDP so relative to that fall, our preferred

way forward would entail an increase. And if you assume that the Guarantee Credit would be linked to prices not earnings, that fall would be still more dramatic to 5.5% GDP, though of course with major implications for pensioner poverty. The relative cost of our preferred way forward versus these different scenarios, in current earnings terms and in real pounds billion, is illustrated in the pack, and I would be happy to answer questions on them.

On Figure Ex 8 the last line talks of “ideally” making the BSP universal in payment today, above some age such as 75. Let me explain.

The Commission’s initial remit was to advise on the pension system looking forward, not on how to put right inherited problems. Government has however asked us to look specifically at issues relating to women. And the biggest such problems relate to today’s women pensioners. Looking forward the position of women, though far from perfect, will improve even without policy change. But many current women pensioners fell between the gaps of the past contributory system.

There are two ways to address those problems. One is through means tested targeting. The other is to introduce a universal non contributory pension . But applied to all pensioners that’s very expensive, and much of the actual financial benefit would flow to better-off pensioners. The intermediate policy, which deserves consideration, is to introduce a universal basic state pension beyond a certain age such as 75. The cost of this would be partially offset by reduced means-tested benefits, but the net cost is still significant, and it would take public pension expenditure above the envelope we have suggested. It is highly desirable, but in a different category from our other proposals, focused on putting right past problems, not creating a new settlement for the future.

[Slide 13]. Those then are our key proposals. In debating them, however, we should distinguish between overall objectives and principles, versus details and

timing. We have made suggestions on the details, but there could be other ways to achieve the same ends. But the overall structure of the new pension settlement, and the role that the state should play are, we believe, clear.

- State pension expenditure should be concentrated on providing as generous and as non-means-tested flat rate provision as affordable, ensuring that people are kept out of poverty in retirement, and creating a sound base on which private savings can build
- Earnings-related provision should be built through a strong system of funded savings, either by individuals or by employers on their behalf, with the state encouraging people to save, and enabling them to save at low cost, but ultimately leaving it to individuals to make their own tradeoffs between savings level, retirement age, and retirement income in the light of their own preferences and circumstances.

A system based on these principles will we believe help ensure that there is no future pension crisis, and help ensure that increasing life expectancy can be seen not as a problem, but as a wonderful opportunity.