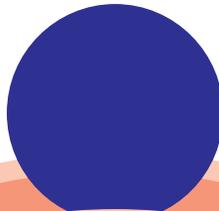
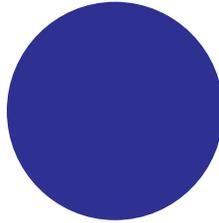




What if? A UK model for compulsory pensions

**Report of the SMF Working Group
on Pension Compulsion**



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First published by
The Social Market Foundation,
November 2005

The Social Market Foundation
11 Tufton Street
London SW1P 3QB

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Executive Summary

Introduction

This document describes a model UK pension system with increased compulsion. It answers the question: if the Turner Commission suggests extending compulsion in the UK pensions system, what would be the best way to do it? It does not discuss whether compulsion is the right policy for the UK.

It was designed by a working group of experts on different aspects of the UK pension system: Michael Wadsworth, *ex* Watson Wyatt (chair); Harriet Hall, FSA Consumer Panel; Joanne Segars, NAPF; and Sarah Smith, University of Bristol. The Secretary to the Working Group was Robin Harding, Economist at the Social Market Foundation.

The Basic State Pension and State Second Pension are already compulsory. Extending compulsion would mean increasing the percentage of earnings that had to be paid into a pension.

The objectives we adopted for a compulsory pension scheme are:

- (1) to ensure comfort in retirement for anyone who had reasonable earnings during their working life,
- (2) to free sufficient state resources to ensure adequate pensions for those who have not had reasonable earnings during their working life.

A secondary objective is to reduce reliance on means-tested benefits to the greatest extent possible.

We chose comfort in retirement as an objective because: (a) it is the aspiration of most pensioners; (b) people may be reluctant to save beyond the compulsory level; and (c) with any lower target there is no margin for error. We found that achiev-

ing these targets through the compulsory system alone was too burdensome. We have therefore designed the system as a base from which these targets can be met.

We have designed the system to have zero net cost to the state in the short-term. In the long-term we believe additional government resources will be needed to maintain any pension system with an ageing population.

Opting for a three-tiered system, we have designed a non-contributory 1st tier with the following structure:

1st Tier - State Pension

We propose that compulsion be backed by a 'Citizen's Pension,' starting at 25% of median earnings, indexed to National Average Earnings, and funded by the abolition of the Basic State Pension, the State Second Pension and contracting out. An entitlement to 1/30th of the pension would accrue for each year of residence in the UK aged 18+.

A Citizen's Pension alongside compulsion makes sense because: it is the fastest way to improve pensions and pensions coverage for those in greatest need; it simplifies the pension system and lowers administration costs; it guarantees investors that compulsory saving is in addition to state benefits, which makes compulsion easier to justify; it lowers the headline level of compulsion needed to achieve a given income replacement rate; and it provides a decent fallback, which allows more investment risk to be taken in the 2nd tier.

	Structure	Change
Pension Level	Pension Credit level - £109 p.w., initially 25% of median earnings, then indexed to average earnings (NAE)	Large rise in basic pension. Change link from inflation to average earnings (NAE) ¹
Pension Entitlement	Universal linked to residency. Entitlement to 1/30th of the pension for each year of residence in the UK aged >18	Basic pension no longer contributory
Pension Age	65 (but may rise in future to support pension link to earnings)	Index to population longevity
S2P/ Contracting-out	Abolished	Releases funding to increase the basic pension ²
Minimum Income Guarantee	Remains for those without residency entitlement	Largely eliminated
Implementation	To be brought in within a Parliament	

To ensure comfort in retirement, the 2nd tier of compulsion should have the following characteristics:

2nd Tier - Compulsory pension

	Structure
Contributions (% of earnings)	10%
Employer/employee	Minimum employer contribution of 5%
Minimum income threshold	£5,700 p.a. (new state pension level)
Maximum income threshold	£25,000 p.a. (pre-tax income) - no contributions above this level (£1,930 per annum)
Forecast actual replacement rate	(Pre-retirement income-contributions per month-replacement rate) <£7,200 - £0 p.m. - 100%+ £10,000 - £0 p.m. - 72% £15,000 - £35.83 p.m. - 57% £20,000 - £77.50 p.m. - 50% £25,000 - £119.17 p.m. - 46%
Provision for low incomes	No contributions on income below £5,700 Flat-rate government contribution (approx. £500) means no individual (or employer) contribution from incomes below £10,700
Provision for self-employed	Self-employed and others not meeting required arrangement for compulsion to be covered with contributions collected via NI system
Minimum/maximum pension age	SPA +/- 10 years
Conditions for early access to pension	Permitted only in response to 'severe ill health'
Pension vehicle	Agnostic between existing vehicles but price cap is entry ticket to operate in compulsory pensions market Default fund for those not making a choice
Asset allocation	No prescription but price cap will encourage passive management Default asset allocation in line with age
Maximum pension charges	Existing stakeholder price cap (excluding distribution loading) of 1.0% Compulsion reduces selling costs and brings economies of scale in administration
Benefit withdrawal	Pensions to be taken in income form (no lump sums) Annuities should be unisex
Government guarantee	No government guarantee but generous basic pension
Pension taxation	Government Contribution to cover the first £500 of compulsory contributions for every citizen to replace tax relief No tax on investment income within pension funds Normal income tax on withdrawals from pension funds
Implementation	10% contribution level phased-in incrementally over 5 years, at 2% points each year

We recommend compulsory contributions of 10% in a British system, paid on income between £5,700 - £25,000 per annum, with a minimum of half (5%) to be paid by employers.

Our initial modelling found that achieving 'comfort in retirement' through the compulsion system alone requires an onerous level of contributions. Even with a Citizen's Pension, someone on £15,000 per annum would have to pay £1,350 of that (17% of salary above £4,000) to their pension in order to reach a replacement rate of 75%.

We note that: (a) this level of compulsion would be a great burden to those on mid-to-low incomes; (b) public support for rates of compulsion above 10% is weak; and (c) that the average pension contribution at present is around 7-10%. A compulsion rate of 10%, therefore, minimises disruption to those who are already making adequate contributions, and delivers strong replacement rates at lower incomes.

We chose £5,700 as the minimum threshold because it would be the new Citizen's Pension level. We chose a maximum income threshold for contributions of £25,000, low compared to Australia or Chile, in order to maximise public support for the scheme, and to avoid compulsion where it is not necessary.

We recognise that, in well-functioning markets, employer and employee contributions are the same: if employers pay then wages would fall to compensate. Given this similarity, and as we would not want to undermine the contribution already made by many employers, we think at least half the compulsory contribution should come from them. Public support for compulsion is strongest with a 50:50 split.

Coverage should be as wide as possible and should include the self-employed despite the practical difficulties of measuring income. To be worthwhile, compulsion has to cover under-pensioned groups like the self-employed, and not to do so is unfair to the rest of the population. The self-employed could pay their contributions through the National Insurance system or certify that they had done so privately.

We propose that the government pay £500 in contributions for every citizen of working age. This would be funded by the withdrawal of existing tax relief for pension contributions. The Government Contribution would be offset against the contribution of the employer and the employee depending on the share they each paid (i.e. with a 50:50 split, both would have their contribution reduced by £250).

Without extra support an effective compulsion scheme would be unbearable to those on low incomes: compulsion either needs extra government money or the redistribution of existing, regressive tax relief. A Government Contribution of £500 ensures that compulsion places no new burden on individuals (or their employers) with incomes below £10,700.

Redistributing tax relief causes political and practical difficulties for existing defined benefit pensions and for higher-rate taxpayers.

Compulsion should bring economies of scale and lower the costs of selling and advice. Existing pension vehicles could therefore be used for compulsory savings, but these should be subject to the current stakeholder price cap of 1% (rather than the new 1.5%), in order to encourage consolidation, reduce competition for switchers, and discourage expensive, active asset management.

There should be a default fund for those who do not wish to make an active choice. This could be provided through a public body that tendered with private companies for administration and asset management services.

It should be hard to access compulsory savings so as to be sure that they achieve their purpose. We suggest that the pension be accessible no earlier than the State Pension Age minus ten years (currently 55) except for grounds of 'severe ill health'.

Having targeted resources on those with lower incomes, the first two tiers should be complemented by a 3rd tier that provides flexibility and revitalises the voluntary system:

3rd Tier - Voluntary saving

	Structure
Contributions	Voluntary contributions up to £20,000 p.a. (inclusive of existing ISA limit of £7,000)
Taxation	No tax relief on contributions No tax on investment income within fund No income tax on withdrawals
Conditions for early access	Full amount can be drawn as a tax-free lump-sum at anytime
Pension vehicle/asset allocation	Market driven Full choice of investments within normal prudential regulation
Employer contributions	To be permitted directly into the employee selected ISA to facilitate workplace collection of contributions

We recommend an extended ISA regime to compensate high-earners for reduced tax relief and in lieu of lump sum benefits. Any saving outside the compulsory system would go to this kind of vehicle. Wealthier investors often complain that the pension system is too inflexible: flexibility would be traded for lower government support.

This provides some support for existing, more generous, employer pension schemes, and signals government support for long-term savings beyond the minimum compulsory level.

Transition

The 10% rate of compulsion could be introduced over five years, with the rate rising by 2% per annum, and the amount required from the employer rising by 1% per annum. Those at or over the minimum pension age (of 55) on day one could opt out. Changes to the tax regime, for simplicity, would have to happen from the start.

We support the NAPF's proposals for an immediate transition to a Citizen's Pension.

We recommend a rapid introduction in order that the policy take effect as soon as possible and so that political consensus need not be sustained for a long period. Pre-conditions for this are: (a) a period of strong nominal wage growth; and (b) effective communication that compulsion will mean slower growth in wages. Otherwise, compulsion could be inflationary.

Cost

The NAPF finds the short-run cost of a Citizen's Pension to be zero, and the long-run cost to be 2.5% of GDP, compared to the status quo. We recognise this is a huge shift but believe that it will become a political imperative as the population ages and the value of the state pension declines in real terms.

Existing tax relief costs £17bn and a £500 contribution for all 33.5m of the unretired, working-age population would also cost around £17bn.

There would, however, be changes to behaviour in response to the change in tax relief. In particular, hours worked might fall, more saving might move offshore, and to the extent that compulsion raised savings, more investment income might be sheltered from tax. We estimate this effect might be in the region of £4-6bn.

This would be offset by savings on the removal of tax-free lump sums, of perhaps £3bn over the long-term, and from reduced benefits to pensioners on low incomes, saving perhaps £1bn.

We therefore believe that the compulsory system would have zero or negligible net cost to the government in the short term.

The extended ISA regime is unlikely to cost much tax revenue. Most investment income on it would simply be displaced from that currently paid on pensions. The relief would take many years to build up and the cost of relief on existing, vast pension assets is not that great.

Impact

The system would cut pensioner poverty: the minimum pension, £7,200 (£5,700 of state pension plus £1,500 of forecast private pension), is more than at present. Carers, women, the disabled, and those with mid-to-low incomes or interrupted work histories would be winners.

The system is redistributive compared to the status quo. The withdrawal of tax relief means that mid-to-high earners would lose under the new system. Employers and the self-employed would also suffer an increased burden.

The maximum possible compulsory contribution is £1,430 per annum. Assuming an employer paid the minimum half of this, the maximum individual contribution is £715, and we believe this would be acceptable to the public.

The system would cut pensioner poverty: the minimum pension, £7,200 (£5,700 of state pension plus £1,500 of forecast private pension), is more than at present. Carers, women, the disabled, and those with mid-to-low incomes or interrupted work histories would be winners.

The retirement incomes produced fall below the Pensions Commission targets, but meet them at lower income levels, and provide a firm base for wealthier individuals to add voluntary savings. Private pension coverage would rise to nearly 100%: those without pensions would benefit from the new coverage (but face the burden of contributions).

We consider that the Australian evidence shows an increase in overall saving after the introduction of compulsion and believe the UK would follow this example. The greatest negative effect would be on existing defined benefit pensions. These rely on tax relief and, without it, would have three choices: to (1) increase employee contributions; (2) increase employer contributions; or (3) cut benefits or close the scheme. The effect would be particularly harsh on those with an existing deficit or those with many well-paid members.

In the long-run, defined benefit pension provision is in decline, and this makes it all the more important to ensure adequate defined contribution (DC) provision. In the short-run, there is a risk of being arbitrary and unfair to defined benefit (DB) funds, and further damaging an important part of the pension system.

To mitigate this, the government may wish to: (a) allow current tax rules to apply for filling existing DB deficits; (b) continue to provide higher tax relief to DB pensions during a transition period; and/or (c) provide some mechanism for firms to transfer existing DB promises or longevity risk to the government.

There should be provision for DB plans to continue to operate on an unfunded basis with tax relief given when the pension is paid. This is equivalent to a firm issuing deferred loan stock to an employee and may be an attractive way for firms to reward important employees.

Presentation

The system could be sold as fair and effective. The system treats everybody the same: everybody contributes at the same rate and tax relief is divided equally. Existing inequalities in pension provision would be reduced and people could feel confident about retirement.

The income range for compulsion, £5,700 - £25,000 has

been kept to a minimum, as have contributions; the principle of a 50:50 split between employers and employees also appeals as being fair.

Many higher-rate taxpayers would oppose the scheme. The best response is the increased flexibility available in tax-free saving.

There would also be opposition from employers, particularly those sponsoring DB pensions. The extra burden on employers, however, is not that great. Many already make pension contributions and the infrastructure to collect contributions through the payroll already exists.

The attempt to design a system makes it clear that three goals - zero net cost to the government, little burden to those on low incomes, and keeping existing tax relief - are not compatible and political consensus will therefore be hard to achieve.

Conclusions

The pension system we set out is based on a higher, universal state pension, and compulsory contributions of 10%. It would fill the existing gaps in pension coverage. By changes to tax relief it spreads the burden of extra contributions across the income scale.

On the other hand, this system would speed the decline of defined benefit pension funds. The redistribution built into it may mean that it could not win political consensus.

The difficulty of designing a compulsory system is that, used as the sole policy to improve pensions for the worse off, its impact is intolerable. With no other change from the existing system, the necessary contributions, even from a low income, can be 15-18% of annual earnings.

This would probably not be acceptable to the public. If there were financial support to mitigate the impact on the worse off, the government either has to spend more money on pensions, or take the political pain of redistributing existing tax relief.

Compulsion works better if accompanied by reform of the state system. It makes it easier to provide good coverage without painfully high contributions from low incomes. It also reduces the need for means-testing.

Employer versus employee contributions, on the other

hand, may not be such a major issue. There is a trade-off between employer contributions and wages and, so long as this works, employers can probably be persuaded to play their part.

We conclude that compulsion could achieve what its advocates claim: it could meet reasonable objectives for higher pensions and better pension coverage.

However, the mathematics of demography and population ageing still apply. To work, compulsion has to extract a larger share of national income for pensions, and government would have to balance a rate of compulsion acceptable to the public, the cost of extra government spending, and reform of the state system.

This report presents one way to find that balance.

Members of the working group

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Harriet Hall - FSA Consumer Panel

Harriet Hall is a solicitor with considerable experience of consumer policy and retail financial services. She is a member of the Financial Services Consumer Panel, which advises the Financial Services Authority on the impact of regulation on consumer. She was formerly the legal officer with the National Consumer Council, where she worked on consumer policy in relation to credit, debt insurance, and the regulation of financial services generally.

Joanne Segars - Policy Director, National Association of Pension Funds

Joanne Segars joined the NAPF in 2005 as Policy Director and Deputy to the Director. Between 2001-05 she was Head of Pensions and Savings at the Association of British Insurers before which she was Senior Pensions Policy Officer at the TUC. She was awarded an OBE for services to the pensions industry in 2003, is a founder governor and council member of the Pensions Policy Institute, and was a member of the board of the Occupational Pensions Regulatory Authority between 1996-2003.

Sarah Smith - Senior Research Fellow, Centre for Market and Public Organisation, Department of Economics, University of Bristol
Sarah Smith managed the economics of financial regulation

team at the Financial Services Authority between 2001-03, where she co-authored the FSA report on the implications of an ageing population, was an economic adviser on saving incentives at HM Treasury in 2000, and has held a variety of posts at the Institute of Fiscal Studies where she is a research associate. Her research interests include applied public policy analysis; micro-analysis of household behaviour in relation to savings, pensions and retirement behaviour. She has published widely on these topics in academic and policy journals.

We would like to give special thanks to Trevor Matthews, Chief Executive, UK Life and Pensions, Standard Life, for his very helpful contributions to our deliberations.

(1) Introduction

The SMF working group on pension compulsion

The SMF working group was not set up to ask whether compulsion is the correct answer to the problems identified by the Pensions Commission and this document does not attempt to do that. Instead, we asked how increased compulsion could best be achieved, should the Pensions Commission favour it as a policy. We met six times, between June and September 2005, to design a pension system with increased compulsion.

Participants had and have a range of views as to whether compulsion is a desirable option, but are committed to examining what a compulsory scheme might look like in practice, with a view to analysing its advantages and disadvantages. This document represents our collective view and not the opinions of individual members or the institutions to which they are affiliated.

By setting out how increased compulsion might work we hope to contribute to the debate on whether to introduce it. We include some tentative conclusions on compulsion as a policy.

The scene set by the Pensions Commission

The Pensions Commission was set up by the government to report and advise on the UK pension system. Its first report, released in October 2004, sets out the future in stark terms.³ Life expectancy is growing rapidly, the birth rate is relatively low, and the percentage of the population aged over 65 will likely double by 2050 as a result. That means a choice between four options:

- a. pensioners will become poorer relative to the rest of society,
- b. taxes/National Insurance contributions devoted to pensions must rise,
- c. the savings rate must rise,

- d. average retirement ages must rise.

The Pensions Commission argues that the solution must be some combination of options b to d. In terms of raising the available funding for pensions it points to the following options:

- i. a revitalised voluntary system and/or
- ii. significant changes to the state system and/or
- iii. an increased level of compulsory private pension saving.

The British pension system already features compulsion. Anybody earning more than £4,108 in 2004/05 must pay National Insurance contributions to earn an entitlement to the Basic State Pension (BSP). They must also pay into the State Second Pension (S2P) or a contracted-out, private sector scheme. Extending compulsion would mean increasing the percentage of earnings that had to be contributed to a pension.

Objectives of compulsion

The primary objectives we adopted for a compulsory pension scheme are:

- (1) to ensure comfort in retirement for anyone who had reasonable earnings during their working life,
- (2) to free sufficient state resources to ensure adequate pensions for those who have not had reasonable earnings during their working life.

A secondary objective is to reduce reliance on means-tested benefits to the greatest extent possible.

We agreed that comfort in retirement, rather than providing a minimum income, should be the goal of a compulsory pension system. This is because (a) comfort in retirement is the aspiration of most pensioners and the system should aim to satisfy them; (b) by setting a level of compulsory savings, government would be giving a signal about the amount people need to save, and persuading people to save beyond it would be difficult; and (c) predicting the amount of saving required to generate a given income in retirement is hard, and setting a minimum target would leave the risk that people found themselves below it.

We believe that 'comfort in retirement' is well defined by the Pensions Commission's suggestion of necessary replacement rates (retirement income as a percentage of income in work) of 80% for someone on £9,000 per year and 67% for someone on median earnings (£21,250), falling to 50% for someone on £50,000 per year.

To reach these replacement rates burdensome contributions would be needed. We have had to trade off the objective of comfort against what seems practically and politically possible.

Assumptions and constraints

We have chosen to design the compulsory element of our system such that it has minimal extra costs for government. This has meant certain choices, which we have clearly signalled. Government spending on pensions - in the public sector, for the Guarantee Credit, and for the state pension - is set to rise automatically with the ageing population. A system reliant on more government spending would clash with the pressing need to control state expenditure on pensions. Introducing a compulsory system, already hard, would be even more difficult if accompanied by tax rises to pay for increased state spending; part of the rationale for compulsion is to keep savings in private hands, and avoid folding everything into the tax system.

We have assumed in our modelling that the state pension age remains at 65. In practice, this may be part of the answer to improving pensions, but our system is not dependent on it. Other modelling assumptions are:

- compulsory contributions taken from after-tax pay,
- pension accrued over 40 years,
- 5% annuity conversion rate,
- return on contributions of average earnings growth +2% per annum,
- the last two assumptions are simplified to the estimate of a pension three times the contribution level, i.e. £500 contributions for 40 years produce £1,500 of pension at 65.

The modelling used is deliberately basic and produces only average figures: the actual outcomes for individuals will differ from those forecast. Our intention is to give an idea of how the tax incentives, contribution rates etc. that we choose relate to

pension outcomes without leaving a spurious sense of accuracy.

All figures quoted in this document are for the 2004/05 financial year unless otherwise stated.

Detail on the existing pensions system, its problems, and the options for a compulsory system are not referred to in detail here, but are discussed in the first paper from this project, *Increased Pension Compulsion in the UK*.

(2) Structure

Table 1 sets out the overall structure of the compulsory pension system we propose. Differences from the existing system are:

- The conversion of the Basic State Pension, the State Second Pension (S2P), and contracted-out rebates into a single, flat-rate, non-contributory state pension based on citizenship.
- A new, second-tier pension, based on compulsory saving into a private fund.
- A third tier of voluntary private saving, supported by tax incentives, but of reduced importance thanks to compulsory saving.

Table 1: Structure of proposed pension system

	Description	Type of Benefit	Contributory?	State or Private	Funding
Tier 1 - State	Flat-rate Citizens' Pension	Defined Benefit	Non-contributory	State	Unfunded
Tier 2 - Compulsory	Compulsory additional pension	Defined Contribution	Contributory	Private	Funded/Notionally Funded ⁴
Tier 3 - Voluntary	Voluntary savings	Defined Contribution	Contributory	Private	Funded

There is wide recognition that the state pension system - contacting out, rebates, the S2P accumulated at different rates based on income - is too complicated, costs too much to administer, and is poorly understood by the public. This is the case for the abolition of the state second tier. If done, there is a gap for a universal pension that varies with a person's earnings, and this is filled by our compulsory system. We therefore maintain the three-tier structure, widely used around the world, but greatly simplified.

It would be possible to design a system, much like the first tier of the Swedish system, where compulsory contributions are paid to the state and benefits are paid on an unfunded basis. We rejected this option in order that compulsory savings in the second tier are not seen as a tax, as they would be if contributions went to the state; in order to maintain or increase the degree of funding in the system; and to minimise as far as possible disruption to the existing system of pension provision.

(3) State pension

We recommend that any private compulsory pension be backed by a Citizen's Pension paid at the Pension Credit level of £109 p.w., indexed to National Average Earnings (NAE), and funded by the abolition of the S2P and contracting out. An entitlement to 1/30th of this pension would accumulate for each year of residence in the UK, from age 18 up, for a maximum of 30 years.

This closely follows the Citizen's Pension model put forward by the National Association of Pension Funds (NAPF) save for a tighter residency requirement.⁵ The NAPF propose only ten years residency in the UK in a period of 20 years before or after the state pension age for full entitlement to a Citizen's Pension. Whilst we agree that ten years would not significantly increase the number of people eligible or encourage 'benefit tourism' we think that: (a) the period should be longer, and (b) the pension should be proportional to the number of years resident in the UK. With such a short qualification period there would be a perception that some received the pension unfairly even if this was not a fact.

Table 2: State pension summary

	Structure	Change
Pension Level	Pension Credit level - £109 p.w., initially 25% of median earnings, then indexed to average earnings (NAE) ⁶	Large rise in basic pension. Change link from inflation to average earnings (NAE)
Pension Entitlement	Universal linked to residency Entitlement to 1/30th of the pension for each year of residence in the UK aged >18	Basic pension no longer contributory
Pension Age	65 (but may rise in future to support pension link to earnings)	Index to population longevity

S2P/ Contracting-out	Abolished	Releases funding to increase the basic pension ⁷
Minimum Income Guarantee	Remains for those without residency entitlement	Largely eliminated
Implementation	To be brought in within a Parliament	

There are some concerns about the cost and difficulty of administering a residency qualification. Residence tests, for tax purposes, already exist and these could be reused for pension qualification. It might prove hard to establish historic residency during the transition: a qualification like the NAPF proposed might have to be used for those near retirement when the reform was implemented. In the long-run, Denmark and the Netherlands demonstrate that such administration is viable, and at reasonable cost.

Table 3: Citizenship rules

Denmark	1/40th of total for each year of residence between age 15-65
Netherlands	1/50th of total for each year of residence between age 15-65
New Zealand	10 years of residence age 20+; 5 years of residence age 50+
NAPF Proposal	10 years residence in a continuous 20 year period
SMF Proposal	1/30th of total for each year of residence aged 18+

We are convinced of the benefits of a Citizen's Pension: it is simple, fairer to women, carers and those on the edge of the labour market, and effective against poverty. What is more, we believe it would make a compulsory system work better.

Why a Citizen's Pension with compulsion?

Compulsion does not require better state pensions. In Australia it is a way to avoid them: the only state pensions are means-tested, and paid to those who have not worked enough to accumulate compulsory savings. In the British context, however, compulsion is no use without better state provision because:

- It is too slow to help those in greatest need: people on low-to-moderate incomes with little or no pension savings. Any compulsion system will take years to mature; those aged, for example, 50 at present will not have accumulated enough by

the time they retire. In the long-run compulsion will help, but current pensioners have little interest in the long-run.

- The alternative to better state provision is to have compulsion alongside the existing means test. The result, however, would be low earners making compulsory contributions to no gain, because their pension did not reach the means-tested level. Aggravating an already unfair means test is no policy and would lose public support. Ending the means test, by contrast, sends a clear message: “You will keep any money you are compelled to save.”
- Lower state provision increases the rate of compulsion needed to achieve a decent pension. For example, if the state pension remained at £82.05 per week, a person earning £15,000 would have to contribute an extra £500 a year to their compulsory pension to achieve the same retirement income, another 3% of their gross earnings. The higher the contribution rate, the harder it will be to win public support.
- If a compulsory pension is private and has no state guarantee then savers will be exposed to investment risk. If their investments perform poorly they will rely more on the state pension; if it is inadequate, the overall system will fail, and those who lose out will resent it.

(4) Compulsory pension

In a British compulsory pension system we recommend that every working person, by law, be required to pay 10% of his or her gross salary between £5,700 and £25,000 into a pension. Of this 10% their employer should be required to pay a minimum of 5% - half of the total - and should be responsible for collecting the contributions.

We recommend the redirection of tax relief on pensions in a compulsory system. Instead of granting relief at an individual's marginal tax rate the government should pay £500 in contributions for everybody: the Government Contribution. This would be paid directly to an individual's pension account with a corresponding reduction in the amount paid by them or their employer. As at present, there would be no tax on investment income within funds, and normal income tax when people draw an income in retirement.

In a British compulsory pension system we recommend that every working person, by law, be required to pay 10% of his or her gross salary between £5,700 and £25,000 into a pension. Of this 10% their employer should be required to pay a minimum of 5% – half of the total – and should be responsible for collecting the contributions.

Table 4: Compulsory pension summary

	Structure
Contributions (% of earnings)	10%
Employer/employee	Minimum employer contribution of 5%
Minimum income	£5,700 p.a. (new state pension level)
Maximum income	£25,000 p.a. (pre-tax income) - no compulsory contributions above this level (£1,930 per annum)
Forecast actual replacement rate	(Pre-retirement income-contributions per month-replacement rate) <£7,200 - £0 p.m. - 100%+ £10,000 - £0 p.m. - 72% £15,000 - £35.83 p.m. - 57% £20,000 - £77.50 p.m. - 50% £25,000 - £119.17 p.m. - 46%
Provision for low incomes	No contributions on income below £5,700 Flat-rate government contribution (approx. £500) means no individual (or employer) contribution from incomes below £10,700
Provision for self-employed	Self-employed and others not meeting required arrangement for compulsion to be covered with contributions collected via NI system
Minimum/maximum pension age	SPA +/- 10 years
Conditions for early access to pension	Permitted only in response to 'severe ill health'
Pension vehicle	Agnostic between existing vehicles but price cap is entry ticket to operate in compulsory pensions market Default fund for those not making a choice
Asset allocation	No prescription but price cap will encourage passive management Default asset allocation in line with age
Maximum pension charges	Existing stakeholder price cap (excluding distribution loading) of 1.0% Compulsion reduces selling costs and brings economies of scale in administration
Benefit withdrawal	Pensions to be taken in income form (no lump sums) Annuities should be unisex
Government guarantee	No government guarantee but generous basic pension
Pension taxation	Government Contribution to cover the first £500 of compulsory contributions for every citizen to replace tax relief No tax on investment income within pension funds Normal income tax on withdrawals from pension funds
Implementation	10% contribution level phased-in incrementally over 5 years, at 2% points each year

We believe that existing pension vehicles could be used in a compulsory scheme. These, however, should be subject to the current stakeholder price cap of 1% (rather than the new 1.5%). A compulsory pension could be either defined benefit or defined contribution. We envisage that most would be DC but, as in Australia, an actuary could certify that a DB scheme is at least as good as a 10% DC contribution.

For compulsion to have meaning, and to ensure that money saved remains until retirement, early access to funds should be difficult. We recommend that the youngest age for access to a compulsory pension be the state pension age minus ten years (i.e. 55 at present). Earlier access should be on grounds of 'severe ill health' only; retirees should only be able to draw income from their funds, and not lumps of capital.

Coverage should be as universal as possible including the self-employed.

Why should compulsion work like this?

This is not the only conceivable scheme of compulsion - in Australia, for example, compulsion is levied at 9%, the whole burden is placed on employers, the self-employed are exempted, and there is no tax relief on contributions. The working group discussed many variations and settled on this as the best.

In doing so we balanced:

- Designing a system that actually solved the problem of low and variable pension coverage among those on low-to-medium incomes.
- Doing no harm to those same people, either by subjecting them to an intolerable burden of contributions, or by making it too expensive for business to employ them.
- Creating a system that has some chance of public acceptance.
- Minimising the disruption to Britain's existing pension system.

Contribution rate

Initial modelling suggested that, based on the existing state pension system, high contribution rates are needed to reach target incomes in retirement. Table 5 shows that, on a £15,000 income, and even with a higher state pension, contributions of £1,350 a year, 16.8% of salary above £4,000, are needed to reach comfort in retirement.

Table 5: Required contributions for comfort in retirement

Salary	Target Replacement Rate	Required contribution rate (existing state pension)	Per annum contributions (existing state pension)	Required contribution	Per annum contributions
£5,000	100%	0%	£0	0%	£0
£10,000	80%	21.5%	£787	12.8%	£267
£15,000	75%	21.5%	£1,870	16.8%	£1,350
£20,000	70%	20.5%	£2,787	17.3%	£2,267
£25,000	67%	20.0%	£3,704	17.5%	£3,183
£30,000	63%	18.9%	£4,420	16.9%	£3,900
£35,000	60%	18.1%	£5,120	16.5%	£4,600
£40,000	57%	17.3%	£5,720	15.8%	£5,200

Source: SMF modelling. Target replacement rates derived from the Pension Commission estimates. Compulsion is levied from a minimum income of £4,000 with no maximum. All other parameters the same as the pension system outlined below. Note that, with the existing state pension, the required rate includes contributions currently made to the S2P or a contracted-out pension.

We believe that taking contributions of this size would harm those on lower incomes. The loss of £1,350 from a small after-tax income would make it harder to pay a mortgage, support children, or pay off a student loan.

Winning public support for large contributions would be hard. While 73% of those surveyed by the Association of British Insurers thought that compulsion was 'a good idea', and 54% supported contributions of 10% or more, 30% wanted contributions of below 10% or nothing.⁸ This apparent support hides the fact that only 26% support a rate of compulsion that would make them contribute more than they already do. Almost all commentators in Australia recognise that the 9% contribution rate there will not produce adequate pensions but, so far, resistance to a higher rate is too great.

Several surveys have found the average contribution to an employer sponsored DC pension to be around 10%: the NAPF in 2003 a little more than 10%, and the TUC in 2004 10-11%, although the best survey, done in 2003 by the Government Actuary's Department, finds contributions of only 7.8%, excluding schemes with no employer contribution at all.⁹ Higher compulsion, of around 15-18%, would require higher contributions to almost every pension scheme in the country.

Given this evidence, we do not believe compulsion alone

should deliver comfort in retirement for everybody, and have therefore designed the system to achieve two major goals. First, to deliver a good pension to those on lower incomes, who are least likely to be able to save extra themselves; and second, to ensure a good base for comfort at all income levels, such that nobody is without a pension, and most can reach it with other savings.

We believe a compulsory contribution of 10%, coupled with reform to state pensions, is the best format. We have chosen 10% because: (a) with state pension reform, it delivers high replacement rates at lower incomes; (b) it is a level that more than 50% of the surveyed population profess to support; and (c) it is close to the average contribution to an employer sponsored pension - almost all DB pensions, many employer-sponsored DC pensions, and around 25% of personal and stakeholder pensions already receive the necessary contributions.¹⁰ It is the best balance of the goals and constraints that we faced.

Range of income for compulsion

We propose that compulsion be levied on incomes between £5,700 and £25,000 per annum (expressed before tax). The reason for the lower limit is simple: this is the new, higher level we propose for the state pension, and it would be perverse to take contributions from a level of income that we declare to be the minimum a pensioner should receive. Taking contributions below a minimum would cause hardship and reduce incentives to work (discussed further below).

One issue we considered is whether £5,700 should be a compulsion-free allowance for all (i.e. those on an income of £6,000 would pay 10% of the £300 above the limit: £30) or a minimum level to start contributing (i.e. those on an income of £5,700 would contribute nothing, but those on £6,000 would contribute 10% of that amount - or £600 - with the actual amount reduced by tax credits at low incomes).¹¹

Although the second system has advantages - a lower contribution rate is needed to achieve a given income in retirement - we do not recommend it. The system of tax credits involved would be complex and, to succeed with the public, compulsion needs to make pensions simple - a point borne out by the Australian experience.

The Pensions Commission has suggested that above the 90th earnings percentile, about £40,000, the government need not concern itself with pension adequacy; Australia takes compulsory contributions from incomes even greater than this: £49,850.¹² We recommend a much lower maximum, £25,000, in the UK. Again, this deviates from achieving comfort for all within the compulsory system, but compulsion is not a good in itself and should be used on as small a scale as possible. This is consistent with our view of the problem to be solved - inadequate pension contributions amongst groups on low and medium incomes - and our view that those on higher incomes are able to save for retirement.

Employer & employee contributions

We recommend that half (5%) of the contribution come from employers with no prescription for the other half: some employers may choose to pay; others will ask employees to match their contribution. The responsibility for collecting contributions, whoever paid them, would rest with the employer.

It is important to note that, given perfectly functioning markets, there is no economic difference between employer and employee contributions. Employers will pay a greater share of total wages as a pension contribution and, while there may be transition effects if employees will not accept lower nominal wage growth, the long-run effect on overall wages should be negligible. The important objects, therefore, are practicality and simplicity rather than who 'ought' to pay.

We recognise that this is not true at low pay levels and especially near the minimum wage. Employers cannot lower wages below the minimum, so making compulsory contributions would effectively increase labour costs, resulting in either lower profits, less employment, or both. Taking contributions from low paid individuals, on the other hand, will cause hardship and make work less attractive compared to benefits. Low earners will consider income now much more valuable than income in the future, so even though compulsory contributions go to their own pension, they may need and prefer to contribute less money in the present.

For these reasons compulsory contributions should not be levied from either employers or employees at low pay levels.

Instead, we propose an improved state pension (1st Tier, above), a high threshold to start contributing (£5,700), and a Government Contribution to make the actual threshold even higher (£10,700, discussed below).

At higher pay levels it is logical that employers be asked to collect the contributions. Employers already collect income tax and National Insurance, deduct student loan repayments, and process existing pension contributions through their payrolls. They have a close and deep relationship with their employees. Requiring business to collect pension contributions is a burden, especially if they do not already do so, but has far less economic cost than creating a new national bureaucracy to do the job.

Given that employer and employee payments are, in practice, the same, and given that employers are best placed to collect them, it is reasonable that some contributions come directly from them. People are more likely to see employer contributions as a benefit of their job, and more likely to see their own contributions as a tax and an imposition. Just as important, people expect employers to contribute and see it as just that they do: compulsion imposed solely on individuals would be perceived as unfair.

Although the case for employer contributions is stronger than for employee contributions some flexibility is important. Shared responsibility appeals to employers and employees alike: the ABI survey found strongest support for a 50:50 share. Individuals may feel greater ownership of their pension fund if they have to make some direct contribution themselves. The more flexible compulsion can be the better.

The self-employed

There are practical difficulties to bringing the self-employed into a compulsory pension scheme. The self-employed need capital to fund their businesses and suffer volatility in their income and cashflow. Self-assessment of earnings makes it hard to work out the base to levy contributions from. The self-employed are not covered by the compulsory pension schemes in either Australia or Chile.

Nevertheless, a reason to adopt compulsion is to improve pension coverage amongst groups where it is currently low, and

one of those is the self-employed. To make compulsion effective, and to make it fair to the whole population, we believe the self-employed should be covered at the same rate as the employed. We also note that the self-employed already receive, and would continue to receive, better state benefits in proportion to their National Insurance contributions.

The self-employed have to assess their income for tax purposes and engage with the tax and National Insurance bureaucracy. We propose that it also be responsible for collecting contributions from the self-employed, on an annual basis, based on their taxable income. As a more attractive alternative, the self-employed should be able to contribute to an appropriate pension vehicle privately, and then certify each year that they have done so.

We recognise that this will be contentious - opposition to compulsion is strongest amongst the self-employed - and will pose practical problems. It may be necessary to levy compulsion on the self-employed at a lower rate. For credibility, however, we think that any system should attempt to cover the them.

Uneven work records

Irregular workers, those who move in and out of the labour force, are a problem because: (a) 10% contributions will only produce a full pension if they are paid for a full working life, and (b) collecting contributions for short periods of work is bureaucratic, and those who often switch jobs may end up with multiple pension funds, reducing efficiency and increasing costs. Many of those without adequate pensions are irregular workers.

An improved, non-contributory state pension, to provide a basic income and end the problem of inadequate contribution records, is part of the answer for those who work irregularly.

We examined the possibility of a Swedish style system, in which compulsion is in the state sector, and government makes full pension contributions on behalf of those with caring responsibilities, or are simply unemployed. We believe that this would be too costly to government and too complicated to administer and communicate if contributions went to private pensions.

Despite this, we think it is important that irregular workers are supported in a compulsory, second tier pension. To do this we propose that all workers receive a £500 Government Contribution. This would ensure that people of working age could continue to maintain and build up their compulsory pension even when outside the labour force.

Drawing a retirement income

The objective of our system is to improve retirement incomes. If savers can use their funds before they retire, or use them up quickly when they retire, the system might increase overall savings rates but still leave many with an inadequate pension. We therefore believe there should be limited access to compulsory saving funds.

Specifically, we recommend that:

- (a) savers be aged a minimum of the State Pension Age minus ten years (i.e. 55 years old at present) when they start to draw their pension.
- (b) access to funds before that age be only on grounds of 'extreme ill health'. A strong case can be made for other grounds, like adjusting to the costs of a disability, but we judge it important to retain the focus on retirement income.
- (c) all withdrawals from funds be in income form. This does not mean pensioners have to buy an annuity - various forms of income drawdown could be acceptable - but no capital lump sums should be taken from compulsory pensions. In Australia, where lump sums are possible, many pensions are run down early (although the system we propose has no means-testing for those who pass the citizenship test, which reduces the incentive to do this).

None of these involve major changes to the rules on UK pensions that will come into force in April 2006.

Rules to allow early access on one criterion or other are applied across the world. Australia allows early access on compassionate grounds, including adjusting to disability or paying for medical treatment, and also offers access to those unable to meet reasonable and immediate living expenses and in receipt

of benefit for >26 weeks. American 401k schemes offer an even wider range of options for early access, even including college tuition, or paying the deposit on a house. Early access for 'extreme ill health' should prove practical to administrate.

Investment Vehicle

We do not recommend introducing a new pension vehicle specially for compulsory saving. We do, however, recommend a price cap of 1% when any of the existing vehicles are used for compulsion, and the provision of a default fund for individuals or employers who do not want to make their own arrangements.

The government could contract with private organisations to provide this default fund. Investment management and administration could be contracted separately to make managers easy to change. In Sweden a single organisation manages the administration of funds in the private part of the compulsory pension system. The Norwegian Petroleum Investment Fund shows how a government organisation can manage investments through the private sector: it holds tenders for managers to invest portions of its funds in particular specialities. The default fund should have the option to vary risk levels according to age and lifestyle.

The default fund would likely be used most by the self-employed and those of working age but not employed, but it would also be open to employers as an alternative to a stakeholder pension provider. In Sweden, many exercised choice when the system was first introduced, but afterward returned to the default fund.

The range of options for management and investment of compulsory pension funds is wide. Compulsion should lower the cost of investment management: selling costs should fall, with no need to persuade consumers to buy the product in the first place; wider coverage should mean economies of scale in management; a light-touch advice regime should make distribution more efficient, with advice only necessary to explain the risk of different pension investment schemes. Compulsory savings need to be managed in a way that secures these economies but is also tolerable to the savings industry.

We considered a number of approaches, including:

- (a) a centralised system with a limited number of providers in order to control quality, increase scale and lower costs
- (b) a system based on requiring employers to provide access to their own collective investment fund or one covering their industry
- (c) a laissez-faire system in which savers and their employers would have a free choice of pension vehicle
- (d) a system of free choice constrained by regulation to ensure funds meet certain standards.

The attraction of (a) and (b) is that they would promote a smaller number of large funds, with economies of scale, and thus control costs without the need for price regulation. Option (a) does this most thoroughly, but requires the most radical upheaval, and might harm quality and innovation by reducing diversity in the market; (b) would build on the tradition of workplace provision, but puts a further burden on the many employers who use a stakeholder or group personal pension, and could also stifle diversity.

Ultimately we reject both of these options because the UK already has an advanced pension infrastructure. Unlike the case of compulsion in Chile, we need not build a pension system from scratch, and the cost of so doing would outweigh the benefit. The introduction of compulsion would be smoother, and more likely to succeed and be accepted, if as many people as possible can use their existing pension for compulsory contributions.

A laissez-faire system (though regulated to prevent fraud and missellings) would allow diversity to flourish and trust to competition to bring down costs. Personal pension funds often charge a total of 2% per annum and sometimes as much as 3%. By comparison, existing DC employer schemes in the UK charge around 1%. An unregulated system may result in many small-scale funds, with high average charges; competition may express itself in battling to persuade customers to change providers, pushing up advertising costs, and the usual focus on past investment performance.

We therefore believe regulation is needed to deliver the

potential benefits of compulsion. The existing stakeholder pension, with its 1% per annum price cap, has not taken off because the charge is not enough to cover the cost of selling and advice (and the cap is about to move up to 1.5% for this reason). Under compulsion, without these charges, we believe pensions at 1% could make money for providers. Providers would have to find economies of scale under a price cap, encouraging consolidation, and it would be hard to profit by advertising to lure consumers from other providers or by offering expensive, active investment management. Such a system would realise the benefits of compulsion and deliver a stable, low-cost market.

We also recommend that the other stakeholder CAT marks, especially on transfer values, apply to compulsory pensions. This has been a significant problem in Australia. While transfers, which push up costs, should not be encouraged, high transfer costs will: (a) hinder competition in general; and (b) delay consolidation of the existing system, as companies protect their franchise by making it difficult to transfer. The result, in the short-term at least, would be a more complex, more expensive system.

Investing a compulsory pension

We do not consider it necessary to regulate the type of assets or investment strategy a compulsory pension can invest in. This is rightly a matter for the market but we would make two comments.

First, the default vehicle should signal an appropriate investment strategy (i.e. properly diversified; invested in suitably risky assets for long-term savings like a pension). Second, a price cap should encourage passive investment, i.e. buying every share or bond in an index, rather than trying to predict which will perform best. This is cheaper and more suitable to a core investment like a pension.

Real and perceived government guarantee

Government may wish to balance the obligation to make pension contributions by guaranteeing those contributions will not be wasted. It may also face the perception amongst contributors of an effective guarantee because government would not

risk the political backlash of a scheme failing (something that has led to the recent creation of the Pension Protection Fund).

We do not think providing such a guarantee is advisable. The cost would be considerable and, knowing that the guarantee would protect them, investors might take extra risks with their own money. Instead, a guarantee should operate on final pension income, in the form of the higher state pension we propose for the first tier. This would prevent absolute poverty as a result of poor investments while further making clear that a compulsory pension is the property, and responsibility, of the individual and not the government.

Government Contribution

We propose that the government pay the first £500 per annum of compulsory contributions. These would be paid directly into the compulsory savings account of every individual, regardless of their income, and regardless of whether they were working, caring, or unemployed.

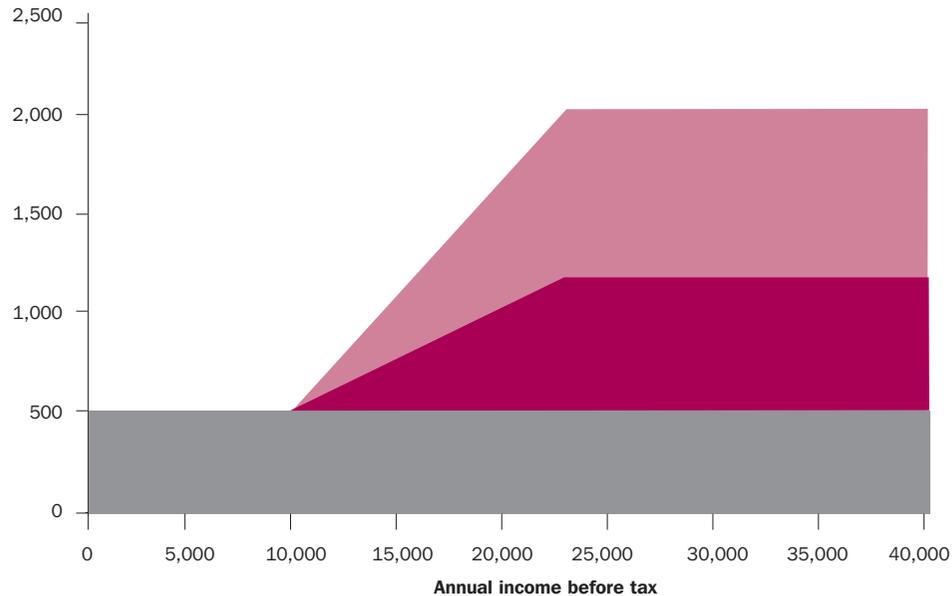
Tax relief would be given to the employer or employee depending on who made the contribution. Employer and employee contributions, after tax relief, would therefore be calculated according to:

$$\begin{aligned} \text{Employer} &= \text{Employer's share of total} \\ &\quad \text{contributions} * \\ &\quad (\text{total contributions} - 500) > 0 \\ \text{Employee} &= \text{Employee's share of total} \\ &\quad \text{contributions} * \\ &\quad (\text{total contributions} - 500) > 0 \end{aligned}$$

So if necessary contributions were £1,000, and the employer paid 100%, their actual bill would be $100\% * (£1,000 - £500) = £500$.

The same system would apply to the self-employed. The government would pay £500 to their compulsory saving account, thus reducing the amount they had to pay themselves.

Figure 1: Compulsory pension contribution by income (5% employer, 5% employee contributions)



This would simplify income tax administration. Government rebates of 22% tax relief to pensions would be replaced by the flat rate, £500 credit. A system for higher-rate taxpayers to claim relief at 40% would no longer be needed.

Taxation is the main policy tool with which government can affect the size of a compulsory pension for different groups and the amount it costs them. Tax credits for private pension saving already exist, paid at an individual's marginal tax rate (i.e. 40% taxpayers receive tax relief at 40%; 22% taxpayers receive tax relief at 22%.)

At present, 55% of tax relief goes to 2.5m higher-rate taxpayers who make up less than 10% of the working age population; the remaining 45% goes to 13m basic rate or non-taxpayers.¹³

The distribution of tax relief for compulsory contributions can be progressive, regressive, or neutral in relation to income. At present the system is regressive (i.e. the higher the income and the higher the pension contribution, the greater the tax relief). Keeping tax relief as it is would minimise disruption to the existing pension system, and minimise (or eliminate) any

effect on medium-to-high earners, making compulsion, in this respect, easy to implement.

Keeping existing tax relief, however, would make an effective compulsion scheme either hard to implement or unbearable to those on low incomes. For example, a single person earning £10,000 per annum pays £1,053 in tax and £605 in National Insurance. They receive £8,342 in net income. Such a person would be liable for £430 p.a. of compulsory contributions (£10,000 - £5,700 times 10%). Tax relief at 22% would pay for £94.60 of this and leave them to find £335.40 from their own pocket: 4% of their net income. This would be hard to bear; it would undermine government objectives on poverty reduction, and might make compulsory pensions a repeat of the poll tax.

Having tested various schemes we judge a flat rate Government Contribution to be best. It ensures nobody has to contribute until his or her income reaches £10,700. It makes the benefits of the compulsory second tier universal: everyone would receive a Government Contribution, and so have a private pension, even if they were not in work at present themselves. It is also in some senses fair: every citizen receives the same universal benefit.

We recognise the considerable difficulties and consequences of redistributing tax credits, notably political repercussions amongst higher earners who lose out, and the effect on existing defined benefit pensions (discussed further below), but we do not believe a fair, compulsory system can be designed without tax support for contributions by those on low incomes. This system has been designed to be revenue neutral to the government. The alternative would be more public spending on pensions.

(5) Voluntary saving

Redistribution of tax credits will reduce the benefits enjoyed by higher earners and make pensions a less attractive vehicle for their saving. To compensate, there should be a more liberal tax-free saving regime: an extension to Individual Savings Accounts (ISAs). We suggest that the annual limit for an ISA be raised from £7,000 to £20,000. Any savings outside the compulsory system would go into this kind of vehicle.

Table 6: Voluntary saving summary

Contributions	Voluntary contributions up to £20,000 p.a. (inclusive of existing ISA limit of £7,000)
Taxation	No tax relief on contributions No tax on investment income within fund No income tax on withdrawals
Conditions for early access	Full amount can be drawn as a tax-free lump-sum at anytime
Pension vehicle/asset allocation	Market driven Full choice of investments within normal prudential regulation
Employer contributions	To be permitted directly into the employee selected ISA to facilitate workplace collection of contributions

One of the main complaints amongst wealthier, more sophisticated investors is that the pension system is too prescriptive. Extending the ISA limit gives the better off more freedom to use their money (as the same tax advantages can be achieved without locking funds up in a pension) in return for lower absolute tax advantages.

(6) Transition

We recommend that the 10% rate of compulsion be introduced over five years, with the rate rising by 2% per annum, and the amount required from the employer rising by 1% per annum. To ease transition for existing schemes they could contribute at 10% from the start. Compulsion would not apply to those at or over the minimum pension age (of 55) on the day the first contributions were introduced. Changes to the tax regime, for simplicity, would happen on day one.

The objective of transition should be to minimise disruption, while changing the system quickly enough that it has positive results for those effected, and the original political consensus is not lost. The model of compulsion we suggest involves reform to both state and private pensions. A strong communications effort would be needed to explain the changes.

We support the NAPF's proposals for transition to a Citizen's Pension; they would be speedy and effective.¹⁴ Under these proposals:

- On a given date, C-Day, the Citizen's Pension replaces the Basic State Pension and the State Second Pension.
- Accruals to the BSP and S2P stop; records of existing accruals are maintained.
- Pensioners are paid the higher of the Citizen's Pension level or their accrued state pension under the old system.
- New retirees would receive the Citizen's Pension unless they have already accrued rights to a higher state pension.

Reforms to the first tier, the state pension, would therefore be carried out immediately. The compulsory pension would build on this base. There are two ways to bring in the compulsory pension: by age cohort, with compulsion applying only to a

particular group (e.g. those under 30), and expanding to cover the whole population as that group aged; or by increment, with compulsion applying to everyone but starting at a low rate (e.g. 1%), which then rises year by year. In fact, these are not alternatives: even if compulsion only applied to a particular age group it would still need to be phased in, or that group would lose access to 10% of their income in a single year.

We recommend the latter because, under the former, it will take many years for compulsion to have an effect. Even if the age of introduction were 40, it would still be fifteen years before any retiree drew a compulsory pension, and so (a) pensions coverage would not improve quickly, and (b) the consensus to introduce compulsion would have to hold for a long period. We do recommend that nobody above 55, and already able to draw on their compulsory pension, should have to participate during its introduction. Most would not have time to accumulate a meaningful compulsory pension.

We note that 2% per annum is an aggressive speed for introduction given nominal wage growth of around 4.5%. Two pre-conditions needed for it are first, an acceptable economic backdrop, with robust nominal wage growth, so cash wages could still rise even as compulsion was brought in; and second, effective communication that compulsion will mean slower growth in wages (in exchange for employer contributions), so that it is not inflationary. The support of the labour movement would be particularly important to achieving this.

We do recommend that nobody above 55, and already able to draw on their compulsory pension, should have to participate during its introduction. Most would not have time to accumulate a meaningful compulsory pension.

(7) The cost of the system

State pension

The NAPF and modellers at the Pensions Policy Institute have estimated the cost of a £109 p.w. Citizen's Pension. They estimate a gross cost in 2010 of £36bn, paid for by £12bn saved from offsetting S2P entitlements against the new Citizen's Pension, £11bn from contracting out, £11bn from the Pensions Credit and other benefits, and £2bn from increased income tax receipts for a net cost in the short-run of zero.

Because the proposed Citizen's Pension rises in line with earnings, and the percentage of pensioners in the population is forecast to grow over time, the cost of the Citizen's Pension will grow faster than the economy. Table 7 shows the forecast share of GDP under the present system and under a Citizen's Pension:

Table 7: State pension cost

	Existing State Pension System	Citizen's Pension at £109 p.w.
2010	5.9%	6.0%
2020	5.4%	6.1%
2030	5.7%	7.4%
2040	5.8%	8.2%
2050	5.8%	8.3%

The Citizen's Pension will cost an extra 2.5% of GDP by 2050: a vast amount. The figures for the existing system assume, however, that Britain will see dramatic ageing of its population without diverting any more national resources to state pensions. The indexation of the Basic State Pension to prices means per capita state support for pensioners is forecast to fall indefinitely. This seems both politically implausible (given the

determined voting power of the elderly) and practically wrong. We believe a rise in the region of 2.5% of GDP would fit the ageing population profile and, in reality, prove hard for any government to avoid. The additional cost of the Citizen's Pension could be met by an increase in the SPA to 67 by 2030, and either an increase in the rate of National Insurance contributions or a further increase in the SPA to 69 by 2040.

Compulsory pension

Employers and employees would make compulsory payments to pensions. There is no direct cost to government but there is an effect through tax relief. If compulsion were introduced with no reform to tax relief there would still be a cost to government: increased pension saving would increase tax relief on pensions.¹⁵ With reform, the net cost to government would be the new cost of tax relief minus the cost at present.¹⁶

Table 8: Cost of tax relief on pensions, 2004-05

Type of contribution	Cost of relief (£bn)
Employee → occupational pensions	3,600
Employer → occupational pensions	11,300
Employee → personal pensions	1,050
Employer → personal pensions	860
Employee → additional voluntary contributions	120
Self-employed → personal pensions	850
National Insurance rebates → personal pensions	214
Pension fund investment income	2,600
Lump sum payments from unfunded schemes	300
Less tax paid on:	
Pension payments (i.e. income tax on retirees)	(8,600)
Refunds to employers in connection with pension surpluses	(23)
Total	12,300

Table 8 shows the cost of tax relief at present.¹⁷ The first five items show the gross cost of tax relief on contributions going into personal pensions: about £17bn. We propose, instead, a £500 relief for every person of working age. With an unretired, working-age population of 33.5m, this would cost approximately £17bn.¹⁸

This analysis is not complete, however, because if tax relief were not available individuals would change their behaviour. In particular, higher earners would try to find other ways to reduce tax on their earnings, so their payments might not offset the fall in tax from the less well off.

Possible changes to behaviour include:

- Reducing income earned in the UK either by avoiding tax residence or working less. Economic estimates suggest a moderate-sized negative relationship between tax and hours worked. Blundell, Duncan and Meghir (1997) derive elasticities of around 0.1-0.15 for women without young children (i.e. for every 1% rise in tax, hours worked fall by 0.1-0.15%).¹⁹ The amount of income tax likely to be lost due to lower hours is still hard to judge but possibly in the region of £4-6bn, short term.
- Switching funds from pensions to other tax-advantaged savings vehicles like ISAs. It is not possible to reduce income tax by doing this, however, and the tax advantages of ISAs would still be no greater than pensions. The higher earners likely to be effected, moreover, probably use their full ISA limit already.
- Increasing saving offshore. Once again, it is not possible to avoid income tax on work done in the UK by saving offshore; the government is moving toward equal tax treatment of UK and offshore pensions. Any effect here would be in the mid- to long-term.
- Lower tax income when pensions are paid because relief has been provided to a poorer group of people. They will therefore fall into a lower tax band when their pensions are paid: this cost will build up over time.
- To the extent that compulsion increases the overall volume of saving in pensions it will increase the cost of tax relief on investment income. As this costs only £2.6bn (in addition to the £17bn) at present, the additional cost is unlikely to be more than £1bn, and this will also take time to build up.

The tax change we propose, therefore, is likely to cost the government several billion in reduced income tax. This is offset, however, two tax benefits not included in the figures above:

- Removal of tax-free lump sums. Under the new Pensions Act 25% of the value of a pension can be taken as a tax-free lump sum on retirement. The Inland Revenue does not estimate the

cost of this but, based on the £8.6bn of income tax it does collect from pensions, it is likely to be substantial: maybe £3bn, but only realised over time.

- Reduction in benefit spending due to better pensions. The £500 government contribution would increase the income of those otherwise likely to receive nothing but the Citizen's Pension. Fewer would therefore be eligible for Council Tax Benefit, Housing Benefit etc. The saving from this, in addition to the savings of the Citizen's Pension, is hard to estimate, but likely to be in the range of £0-1bn.

We therefore believe that the proposed changes to pension tax relief would be broadly revenue neutral for the government.

Voluntary saving

We suggest an increase in the tax-free ISA limit from £7,000 to £20,000 to compensate high-earners for the reduction in tax relief. The government would lose revenue from income and capital gains taxes on the extra money in ISAs.

We do not believe these losses would be substantial.

Higher earners would shift funds from pensions into the new ISAs: these funds are already exempt from tax on investment income: the only loss would be on income tax in retirement. Losses on investment income would only occur if the tax changes as a whole stimulated new saving, above what already goes into pensions and ISAs, by high earners. Even then, relief would take many years to build up, and as Table 9 shows, the cost of relief on well over one trillion pounds of pension assets is not that large.

While there may, therefore, be some long-run costs, we believe the system as a whole is revenue neutral for government.

(8) Impact

Retirement incomes

Table 9 sets out the retirement incomes generated by the state system and compulsory pension we propose. The main characteristics are:

- The minimum pension, £7,200 (£5,700 of state pension plus £1,500 of forecast private pension), is considerable and would cut pensioner poverty.
- The distribution of pension income is relatively flat. Whereas someone earning £5,000 per annum will get £7,200 in retirement, the maximum income is £11,490.
- Replacement rates are excellent at low incomes, moderate at middle incomes, and low further up. Other savings will mean that actual replacement rates at higher incomes are much higher. The Pensions Commission demonstrates that property, inheritance and other assets are concentrated at these income levels.²⁰
- The maximum possible compulsory contribution is £1,430 per annum. Assuming an employer paid the minimum half of this, the maximum individual contribution is £715.

Table 9: Retirement income from state + compulsory pension

Salary £'000	Government contribution (£)	Compulsory contribution (£)	Total pension contribution (£)	Effective tax relief (%)	Pension (£)	Pension + State pension (£)	Replacement rate (%)
5	500	0	500	N/a	1500	7200	144 ²¹
10	500	0	500	N/a	1500	7200	72
15	500	430	930	54	2790	8490	57
20	500	930	1430	35	4290	9990	50
25	500	1430	1930	26	5790	11490	46
30	500	1430	1930	26	5790	11490	38
35	500	1430	1930	26	5790	11490	33
40	500	1430	1930	26	5790	11490	29

Table 10: Proposed system versus Pensions Commission benchmark

Salary	Replacement rate Pensions Commission benchmark	Replacement rate Proposed system
£5,000	80%	144%
£10,000	70%	72%
£15,000	70%	57%
£20,000	67%	50%
£25,000	60%	46%
£30,000	60%	38%
£35,000	60%	33%
£40,000	60%	29%

Table 10 shows how this compares with the Pensions Commission's benchmark replacement rates. The actual replacement rate falls below the benchmark on incomes as low as £11,000. This is not ideal, but shows the considerable trade-offs necessary to design a compulsory system with some chance of public acceptance. By necessity, we leave more provision to individuals than the Pensions Commission suggest.

The system would achieve many ends. The percentage of the population with a private pension would rise from 60% to near 100% - unmatched anywhere in the world. Groups with poor pension provision - women, part-time workers, the disabled, those with interrupted work histories - would particularly benefit.

Savings and debt

An important question is the degree to which compulsion increases saving overall. Households may respond to it by reducing their other savings for no overall effect.

In Australia, estimates of the offset rate, the percentage reduction in other savings for each dollar of compulsory saving, are between 30% and 50%. Studies include:

- Connolly & Kohler (2004) - Offset rate of 38%, equivalent to a 2% rise in household savings, using annual macro data, in a model that corrects for stocks of wealth and financial

deregulation.²² All the studies below are cited in Connolly & Kohler.

- FitzGerald & Harper (1992) & FitzGerald (1993) - Offset rate of 50%, using micro data on liquidity constrained households.
- Corcoran & Richardson (1995) - Offset rate of 17%, using data on the change in voluntary super contributions since 1988.
- Corvick & Higgs (1995) - Offset rate of 37%, using consumption smoothing model on macro data.
- Morling & Subbaraman (1995) - Offset rate of 75%, using the aggregate relationship between super and other savings, 1960-1994. M&S differs from the other studies in that it uses net savings behaviour, and therefore includes those withdrawing funds.
- Gallagher (1997) - Offset rate of 30-50%, using a model based on data from previous studies.

We think it is reasonable to expect that the UK will follow the Australian example and that compulsion will result in an increase in overall savings.

The economy

The effect of an increase in savings would be to raise investment at the expense of consumption. Adair Turner assumes that increased investment causes some fall in the marginal return on capital and sets out two scenarios: one, that the increased savings are mainly invested in the UK, and cause a fall in returns to domestic capital; or two, that capital is invested overseas, though Turner does not consider this possible on a sufficient scale.²³ The scale of this fall in returns may be substantial: Miles (1999) finds that the return on assets could fall from 4.6% in 2000 to 4.2% in 2030, due to demographic change, and to 4.0% if there is a major effort to shift people to funded pensions.²⁴

This is a possible issue with the compulsion scheme we propose but we note that: (a) our system does not involve a dramatic rise in overall pension funding and, (b) it does not restrict investment overseas so, to the greatest extent possible, pensions will earn the international return on capital.

Intergenerational equity

Raising the pay-as-you-go state pension is unfair between gen-

erations, as the current workforce has to pay increased benefits to retirees who did not accrue them. In addition, a decline in the real terms of the state pension is unfair: workers have to pay higher benefits for current retirees than they will receive themselves. Introducing the higher Citizen's Pension is a cause of the first problem, but a link to earnings solves the second.

To the extent that a compulsory pension is truly additional to the state pension it has no effect on intergenerational equity.

Defined benefit pensions

The scheme we propose would have a serious effect on existing DB pensions. DB pensions, particularly those for high earners, rely on 30% tax relief for employers and 22% for employees to increase the value of contributions and fund the pension.

Limiting tax relief would exacerbate existing deficits in DB funds: without tax relief, higher contributions are needed to fill the gap. With less tax relief DB funds would have three choices: to (1) increase employee contributions; (2) increase employer contributions; (3) cut benefits or close the scheme.

The situation is not quite as bad for unfunded DB schemes in the public sector. Employers make only notional contributions and, as they have no profits, they receive no tax relief. Public sector schemes will, however, lose some tax relief from employee contributions so, while options (1) and (3) remain the same, the other option would be: (2) increase the deficit on public DB pension schemes: in effect, leaving the bill to future taxpayers. The flat rate £500 credit would make DB pensions for the low-paid cheaper to fund and offset the cost in the public sector.

What is asked of DB pensions is the same as of DC pensions, but the effect would be worse because they are more generous. DB schemes receive average contributions amounting to 16.2% of salary, 5% from employees and 11.2% from employers, according to the 2000 Government Actuary's Department survey (hereafter GAD 2000).²⁵ The Inland Revenue estimates the average rate of tax relief rate on pension contributions is 27%. This suggests that contributions to a DB pension would have to rise by 37% to maintain benefits in the total absence of tax relief. Tax relief would not disappear completely, however: assuming there are 5m DB scheme members in the private sec-

tor, their £500 of relief would still be worth £2.5bn per annum.

The long-run problem is not too bad: DB pensions are becoming less significant. GAD 2000 found 9.1m people (less than a third of the workforce) enrolled in DB schemes, around half in the public sector, and 0.5m in schemes closed to new members. Since 2000 more private sector schemes have closed, and while reforming tax relief would speed the decline, many consider it to be inevitable anyway.²⁶ The trend away from DB provision is one reason why it is essential to make DC provision more secure. Public sector pensions are generous and, if the objective is fairness, further reform to cut costs is reasonable.

In the short-run, during the transition, the government might have to provide support, which it could do by:

- Allowing contributions to fill existing deficits to be made under the current tax rules. This prevents funds from being unfairly penalised if the reforms are made when they have a deficit.
- Continue to provide higher tax relief to DB pensions for an extended transition. This might be seen as unfair and government would have to accept a large, one-off cost.
- Following recent calls to allow firms to pass some historic DB promises, or some longevity risk, to the government.²⁷ Again, this might prove expensive, as it has done in Japan.

Government might also wish to make provision so that firms that wanted to could still offer DB schemes. This could be done on an unfunded basis and tax relief given, not at the time of contribution, but when the pension was paid. Employees would be exposed to the credit risk of the employer, making this kind of pension the equivalent, in effect, to issuing deferred loan stock to employees. This could be an attractive way for companies to reward their senior executives.

Other existing pensions

The rules we propose do not target any existing pension vehicle. The 1% price cap, however, will mean certain types of pension are unlikely to be used for compulsory pensions.

Table 11: Forecast effects on existing pension vehicles

Scheme type	Forecast effect
Employer DB	Negative due to increased costs
Employer DC	Positive - compulsory employer contribution may encourage new schemes
Industry or collective DC	Positive - employer/self-employed contributions may stimulate new schemes
Group personal pensions	Neutral - cost may be too high
Personal pensions	Too expensive for compulsory pension - use may fall
Self-invested personal pensions	Price cap will limit investments they can hold as a compulsory vehicle
Stakeholder pensions	Positive - large new demand for low-cost pensions

Compulsion would open up new opportunities for the whole savings industry. It would particularly benefit those with the scale to operate stakeholder pensions cheaply, those who administer and invest DC schemes, and cheaper investment management strategies. Personal pension specialists, on the other hand, may see less business.

(9) Presentation

Presentation is the big challenge for a compulsory pension system. Can the obligation to save be sold to the public? This system is designed to be as saleable as possible. Through reform to the state system the compulsory contribution is reduced to 10%; the income range, £5,700 - £25,000, over which compulsion applies, is the smallest possible that will achieve the objectives set. We also believe that the principle of employers paying at least 50% of the contribution will be seen as fair and appeal. Contributions would be kept clear of the tax system and individuals will keep their existing investment choice - compulsion should not be seen as a tax.

A compulsory pension would be sold as fair and effective. The system treats everybody the same: everybody contributes at the same rate; tax relief is divided equally. Existing inequalities in pension provision would be reduced. A strong message is that, under this system, people could feel confident about their retirement.

High-earners affected by the tax changes would be likely to oppose the system. How much this would be realised is hard to judge. At present many middle- and high-earners already make pension contributions of 10%+. The tax change will mean that some of them have to pay a little more (because tax relief no longer takes them above 10% contributions) and some simply accumulate a smaller pension (if their contributions are still above 10% with lower tax relief). Pensions will still be free from tax on investment returns - a significant benefit to high earners - and the expanded ISA regime is deliberately designed to compensate them. One of their most frequent complaints is that the pension regime is too inflexible. Still, although the immediate cash effect may be small, this is a vocal and politically powerful group and their objections are to be reckoned with.

The tax changes would also create institutional opposition from the defined benefit pension sector. As discussed, the cost of maintaining defined benefit pensions would rise substantially, and many that remain in the private sector would likely close. Public sector workers would also see reduction in their generous benefits: tension within the labour movement, between better-off workers in the public sector who already have generous benefits and those outside it who do not, could also be an obstacle.

Opposition from providers of DB pensions would overlap, to some extent, with opposition from employers. Where DB pension provision is not an issue, however, we believe that employer opposition could be overcome. The actual burden imposed on business is not great: their contributions would be offset by lower wages, and the bureaucracy to pay into National Insurance and existing pension plans already exists. A 5% contribution is lower than it might be and less than many already pay.

A compulsion scheme like this would also have powerful supporters. A large percentage of the population would benefit from the redistribution inherent in it. It improves retirement incomes immediately and eliminates means-testing for pensioners. There are new opportunities but no radical changes for the financial services industry. The scheme is an extension to the existing culture and systems of pension provision: many of us already contribute, alongside our employer, to a pension through our workplace. This system tries to formalise that in the least painful way possible.

The attempt to design a system does make it clear that a political consensus will be hard to achieve. Three goals - zero net cost to the government, little burden to those on low incomes, and keeping existing tax relief - are not compatible. Aside from liberal objections, compulsion does not escape the fundamental issue, that the pension system needs more resources, and someone has to provide them.

(10) Conclusion

The pension system we set out is based on a higher, universal state pension, and compulsory contributions of 10%. It would fill the existing gaps in pension coverage. By changes to tax relief it spreads the burden of extra contributions across the income scale.

On the other hand, this system would speed the decline of defined benefit pension funds. The redistribution built into it may mean that it could not win political consensus.

The aim of this project was to design a practical model of a compulsory pension system. This conclusion summarises what the process has taught us.

The heart of the problem in pensions is that while some people are saving enough for a prosperous retirement, others, especially those with lower incomes, are saving little or nothing. The difficulty of designing a compulsory system is that, used as the sole policy to improve pensions for the worse off, its impact is intolerable. With no other change from the existing system, the necessary contributions, even from a low income, can be 15-18% of annual income.

This gives rise to several problems. One is acceptability to the public. We tried to simplify the system and set the compulsion at the minimum compatible with good pension coverage. Another system we considered was to keep a low state pension, have higher compulsory contributions, and more government contributions or credits for those on low incomes. We decided against it, first, because the necessary system of credits would be complex and hard to communicate, and second, because the higher rate of compulsion (15%) would struggle to find support.

Another problem arises if there is financial support to mitigate the impact on the worse off. This has a cost to government, and either it has to provide new money, so the system

becomes more expensive, or it has to make the difficult political decision to redistribute existing support.

Another conclusion is that compulsion works better with reform of the state system. Simply requiring people to put x% of their salary into a pension improves coverage for some on modest incomes, but either x has to be set very high, or else those on low incomes will still have inadequate pensions. There are two ways to reform the state pension: either increase means-tested benefits for poorer pensioners, or raise the state pension for everyone. The first is cheap, but entrenches the culture of means testing; the second costs more, but lowers the percentage of salary everybody is forced to contribute.

One interesting result is that some of the issues we expected to be most contentious were easy to agree. Employer versus employee contributions is one of these. In practice, employer contributions would be offset by lower wages, and there is no reason to think that the share of national income taken by the labour force would grow. There is a real cost to employers from being asked to collect contributions for a compulsory saving system, but estimates of cost in terms of the cash value of contributions are misleading.

We conclude that compulsion could achieve what its advocates claim: it could meet reasonable objectives for higher pensions and better pension coverage. But the mathematics of demography and population ageing still apply. To work, compulsion has to extract a larger share of national income for pensions, and government would still face difficult choices. It would have to balance a rate of compulsion acceptable to the public, the cost of extra government spending, and reform of the state system. It would have to decide where the burden of providing extra pension resources would fall.

We hope this report presents an attractive way to make those choices.

Notes

Executive Summary

- 1 Pensions Policy Institute, *The Pensions Primer*, June 2005, discusses the Pension Credit.
- 2 National Association of Pension Funds, *Towards a Citizen's Pension - Final Report*, September 2005. The funds released cover the short-term costs of a 'Citizen's Pension' only. By 2050 the estimated additional cost is 2.5% of GDP. The system proposed here should cost slightly less as it has a tighter residency requirement.

Introduction

- 3 Pensions Commission, *First Report - Pensions: Challenges and Choices*, 2004, HMSO: London. <http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf>. (16th Feb 2005).
- 4 The public sector pension system, for the time being at least, will likely continue to be pay-as-you-go.
- 5 National Association of Pension Funds, *Towards a Citizen's Pension - Final Report*, September 2005.
- 6 Pensions Policy Institute, *The Pensions Primer*, June 2005 discusses the Pension Credit.
- 7 National Association of Pension Funds, *Towards a Citizen's Pension - Final Report*, September 2005. The funds released cover the short-term costs of a 'Citizen's Pension' only. By 2050 the estimated additional cost is 2.5% of GDP. The system proposed here should cost slightly less as it has a tighter residency requirement.

(4) Compulsory pension

- 8 ABI, *Compulsory pensions - an analysis of public attitudes*, Occasional Paper No. 1, August 2004: London. http://www.abi.org.uk/Display/File/364/Compulsory_Pensions-an_analysis.pdf (30th October 2005).
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- 10 Pensions Commission, *First Report - Pensions: Challenges and Choices*, 2004, HMSO, Fig. 3.34, 4.15: London. <http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf> (16th Feb 2005).
- 11 More detail on this point is available in the initial paper for this project, pp.28-29. Harding, R. & Rossiter, A., *Increased Pension Compulsion in the UK*, July 2005, SMF: London.
- 12 2002/03 level, A\$1 = £0.4265.
- 13 Answer to Parliamentary Question by Steve Webb MP, Hansard 1490W, 11th February 2004.

(6) Transition

- 14 National Association of Pension Funds, *Towards a Citizen's Pension - Final Report*, September 2005, pp 14-26.

(7) The cost of the system

- 15 This is part tax deferral (as income tax is levied on pension incomes) and part relief, as pensioners tend to fall in lower tax bands.
- 16 For further discussion of reform to tax relief see Curry, C. & O'Connell, A., *Tax Relief and Incentives for Pension Saving*, October 2004, Pensions Policy Institute & Age Concern England: London. http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_ACE_report_final.pdf (18th October 2005).
- 17 *Approved pension schemes*, Inland Revenue Statistics Table 7.9, September 2005. http://www.hmrc.gov.uk/stats/pensions/7_9_sep05.pdf (October 17th 2005).
- 18 Working age population from Family Resources Survey 2002-03, quoted in Fig 3.5, Pensions Commission, *First Report - Pensions: Challenges and Choices*, 2004, HMSO: London. <http://www.pensions>
- 19 Blundell, R., Duncan, A. & Meghir, C. (1997) "Estimating labour supply responses using tax reforms," *Econometrica*, 66, pp. 827-862. <http://www.nottingham.ac.uk/~lezad/downloads/rbadcm.pdf> (18th October 2005).

(8) Impact

- 20 Chapter 5, Pensions Commission, *First Report - Pensions: Challenges and Choices*, 2004, HMSO: London. <http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf> (16th Feb 2005).
- 21 Someone earning £5,000 per annum will almost certainly receive one or other benefit hence, in practice, the replacement rate is likely to be below 100%.
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- 27 Willets, D., 'How to get out of the pension ghetto,' *Daily Telegraph*, 18th October 2005. <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2005/10/18/ccpers18.xml&menuId=242&sSheet=/money/2005/10/18/ixcity.html> (18th October 2005).

SMF Publications

Reinventing Government Again

Liam Byrne and Philip Collins (eds.)

2004 marked ten years since the publication of Osborne and Gaebler's landmark book *Reinventing Government*. In *Reinventing Government Again* a number of authors assess the extent to which the ten principles for entrepreneurial government enunciated in the original are reflected in the UK today.

December 2004, £15.00

Too Much, Too Late: Life chances and spending on education and training

Vidhya Alakeson

This report argues that the link between educational attainment and family background will not be broken as long as the pattern of spending on education and training continues to offer a far greater public subsidy to tertiary rather than preschool education. The report proposes a reallocation of spending in the medium term in favour of children under five.

March 2005, £15.00

The Incapacity Trap

Moussa Haddad (ed.)

This report considers a range of complex and often overlapping problems faced by those on incapacity benefit. Its proposals include a new Rehabilitation Benefit with active personalised support to prepare its claimants for work; subsidies for employers to encourage them to take on employees with health conditions; and an expansion of the Access to work scheme to help companies meet the additional costs of taking on those with a disability.

June 2005, £15.00

No More School Run: Proposal for a national yellow bus scheme in the UK

The Sutton Trust

This report argues that a national system of school buses would have a number of benefits: lowering greenhouse gas emissions; improving safety for children; reducing truancy; and enabling the wider community to take advantage of a reliable source of

transport. It also argues that if choice of school is to become a reality for everyone, an effective school transport system is required. June 2005, £10.00

To the Point: A Blueprint for Good Targets

Report of the Social Market Foundation Commission on the use of targets

This report is a thorough examination of the Government's use of targets in four public services: education, health, housing and the criminal justice system. The report sets out the design flaws in the current targets regime but concludes that these flaws are the result of specific design problems. This report presents a range of practical proposals to improve the way in which targets are designed in the future. These are illustrated with a definition with a definition of a "good target", encapsulating the principles of how, and when, targets should be set. September 2005, £15.00

Making Choice a Reality in Secondary Education

Claudia Wood

In this publication the Social Market Foundation argues that the government's proposals on school choice need to be bold and integrated if they are to succeed - or else they risk making an already unfair education system even less equitable when it comes to underprivileged families. The report emphasises the extent to which the English school system has been blighted by inequity of access and outcome and argues that extending choice to all parents could be the key to levelling this playing field. October 2005, £10.00

A New British Energy Policy

Dr Dieter Helm

Recognising the emergence of a new energy paradigm, this report argues that energy policy should adapt to reflect the new priorities of security of supply and climate change. It contends that a new policy framework would help the UK balance the increasing demand-supply tensions in world energy markets while directly addressing the new priorities of energy policy. Ultimately, only an investment-focused energy policy can credibly advance the transition to a low-carbon economy. November 2005, £15.00

If extending compulsion in the UK pensions system is adopted, what might be the best way to introduce it? The SMF established a Working Group to design a compulsory pensions system which would represent the best way forward given the particular features of the UK pensions system. The proposals would ensure comfort in retirement and provide flexibility for a revitalised voluntary system.

The report also suggests that under a compulsory system, the government would not need to use tax incentives to increase savings. Using a non-contributory Citizen's Pension as a building block, the Working Group's model targets resources on those with lower incomes.