Guest Editorial

Never glad confident morning again: Pensions in an age of austerity

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For years now, British Governments of all political persuasions have ceaselessly preached the virtues of private sector pension provision. Where in the 1970s both Conservative and Labour Governments expanded the basic state pension by adding an earnings-related component (SERPS, the forerunner of the State Second Pension), more recent times have seen legislation introduced with the aim of strengthening occupational pensions. This has found its clearest expression in the Pensions Act 2004. The guiding philosophy behind that particular piece of legislation is clear: in return for the Government providing a safety-net for those schemes completely beyond rescue, employers are expected to improve the funding of the pension schemes they are sponsoring. The watchful eye of the Pensions Regulator ensures that employers feel compelled to stick to their end of the bargain by adhering to the new statutory funding regime, purposefully fashioned to prevent the bottom dropping out of pension schemes by getting employers to put in more money as and when required.

The need to boost individual (occupational) pension saving has also driven the concomitant reform of the way in which pensions are taxed. Instead of the previous Inland Revenue regime and its Heath Robinson construct of manifold provisions spread across several Finance Acts, the reforms of 2006 introduced a simple yardstick: individuals would now be allowed to save (attracting tax relief) up to certain set limits, subject to an annual review. Provided individuals kept within these limits, they would be able to build up as much (or as little) pension as they liked.

By 2007/2008, the United Kingdom by and large had the makings of an occupational pension system in place in which considerable freedom to accrue pension was backed up by a legislative framework designed to stop schemes running out of money. Many people might have expected these changes over time to lead to greater stability in pension scheme funding and benefit accrual. The credit crunch and its ensuing horrors put paid to that.

Not surprisingly, the recession that followed the demise of Lehman Brothers in September 2008 has severely upset all calculations. Like the deadly Upas tree, whose poisonous roots kill all vegetation within miles around it, the banking collapse damages everything it touches. Plummeting stock markets, uncertainty surrounding interest rates, low yields on gilts and inflation nudging slowly but stubbornly upwards do not make ideal conditions for stable scheme funding, and many pension schemes have been pushed into the red. Hopes that these schemes might shortly be able to restore their funding positions to good health seem forlorn, especially given the fact that extra cash demands might push already tottery employers into bankruptcy. The Pensions Regulator has wisely decided to be cautious in placing extra financial burdens on straitened employers.

An economic crisis does not provide a propitious backdrop to attempts to enhance occupational pension provision. And so it has proved.

When it took office in May 2010, the Cameron-Clegg coalition Government paid obeisance to the need to revitalise occupational pension provision. The coalition agreement – its

programme for government – speaks of the desire to help reinvigorate occupational pensions by simplifying rules and regulations and encouraging employers to offer high-quality pensions to their employees. Although not exactly a promise to recast the occupational pension sector, it does at least betray an ambition not to let occupational pension schemes slowly wither on the vine. Whether or not a particular pension can be considered to be of high quality is in the eye of the beholder, but a reasonable bystander might have felt confident that the Government was determined to breathe new life into occupational pension schemes. In their election manifestos, the coalition parties had said pretty much the same thing.¹

Since then, however, the Government has focused with almost myopic concentration on the need to reduce Britain's budget deficit, which has left very little room for anything else. The entire political discourse in the United Kingdom is now dominated by gloomy talk of spending cuts, compounded by anxious speculation about the imminence of a double dip recession. Whether the Government's economic strategy will eventually pay off is at present anyone's guess, but the Chancellor, George Osborne, has certainly succeeded in allowing his programme of swingeing deficit cuts to drive all else before it.

Although it is mainly the public sector and its headcount that are feeling the full ferocity of the budget cuts, occupational pension schemes are not out of the firing line either. There is no indication that occupational pension schemes are feeling rejuvenated. Instead, they are being battered by the economic turbulence as much as anything else. And there seems little that the Government can actually do about it. Of course, some might argue that political meddling has done pension schemes no good at all and that a period of benign neglect might be beneficial, but where does that leave the reinvigoration of occupational pensions?

To be fair, the Government has made progress in getting rid of certain rules and restrictions, which were probably obsolete. It has made strides to get rid of the default retirement age of 65, has scrapped certain restrictions on the payment of

lump sums to persons aged over 75 and has also tackled the blatantly unpopular rule that forces people to purchase annuities compulsorily. In addition, the constantly shifting muddle that is 'DC contracting-out' is also being consigned to history, with few mourning its passing. Yet, taken together, these piecemeal measures are hardly likely to beef up occupational pensions.

Indeed, as far as one can tell, very little is actually being done to make it easier for members of occupational pension schemes to build up significant savings. The amount that any person may save (in a tax-advantageous way) on an annual basis was reduced from £255 000 to £50 000 with effect from 6 April 2011. The lifetime allowance (the maximum limit on pension accrual allowed over an individual's working lifetime) will be reduced from £1.8 million to £1.5 million from 6 April 2012. Effectively, the Revenue is diminishing the tax allowance applicable to pension savings in an attempt to get more money out of occupational pension schemes. It would have been almost too good to be true to believe that pension schemes might be excused from having to share in the austerity measures, and one can understand why a cash-strapped Chancellor would wish to do this. But it does seem to sit at odds with the desire to allow occupational pension provision to thrive.

One could credibly argue that having a pension pot of £255 000 can only ever be the privilege of an affluent few, and that therefore little harm is done anyway. After all, the bulk of the population is unlikely to be hurt by this measure, and it probably makes sense to spread tax relief more equitably. But it does not send a positive signal to employees that they are being encouraged to save. The tax rates on the payment of certain lump sum benefits has also been increased, and so in all the impression may well gain ground that pension schemes are once again serving as useful piggybanks to be raided by the taxman in times of need. In an era of general austerity this is not surprising, but it is not a hopeful signal to emit.

The Government has also changed the measure by which pensions in payment are uprated for inflation. Where previously pensions were

adjusted to keep pace with changes in the retail prices index (in other words, the cost of living), the government has now introduced a new system for inflation-proofing, the consumer prices index. This change is ostensibly justified because it better reflects the spending pattern of the average pensioner. However, the likely outcome will be pensions which are less insulated from inflation. Pension increases are in the main likely to be lower. With inflation slowly but surely rearing its ugly head again, this will hit pensioners in their pockets. Although this measure might offer a little relief to pension schemes, it is questionable whether people can feel confident that increasing their exposure to inflation does much for the quality of their retirement.

The Government has said that it is committed to going ahead with the introduction of auto-enrolment from October 2012. This is of course a piece of legislation that was already on the statute book, although many employers regard it as yet another cost they could do without and there have been murmurings arguing for it to be postponed. To its credit, though, the Government seems determined to persist in making auto-enrolment work.

Once the auto-enrolment requirements start to be phased in from October 2012, the inadequate take-up of pension scheme membership should start to be addressed. The measure is designed to avoid certain employees simply falling between two stools and being left without any proper pension provision. Employers will have a choice of enrolling employees either in NEST (National Employment Savings Trust) or a (superior) alternative arrangement. A minimum threshold of employer contributions will be required for an employer to meet the statutory requirements. It is a good start, but it does not change the mundane fact that pension scheme membership will only be valued by employees if it allows them to build up meaningful savings. If auto-enrolment only produces a mouse, voices will eventually be raised querying whether it was worth the effort.

And this really goes to the heart of whether pension schemes will ever again be in a position to offer their members good, affordable retirement benefits. Many of the problems afflicting occupational pension schemes predate the recession, but all that has since happened has clearly added to the woes.

Voters will always yearn for the good life, but at the moment no Government is really in a position to offer any reassurance as to when the good times may return. As far as the UK's occupational pension system is concerned, it seems that there is a sense of resignation that its best days are now behind it. Even those politicians who venture to look beyond the short term in an attempt to outline a policy agenda for the future seem to have little or nothing to say on the question of how occupational pension provision in Britain may one day be revived.²

Enoch Powell once famously said that all political life ends in failure. Surely this does not have to hold true of policies, too. But no amount of policy can rectify a problem if the circumstances are not favourable. Where once it was said that the British occupational pension system was the envy of the world, few would probably now wish to make this boast. Will it ever be glad confident morning again for British pension schemes? One would have to be an inveterate optimist to answer that question in the affirmative.

REFERENCES AND NOTES

- 1 The coalition agreement and the parties' manifestos are usefully collated in Hurst, G. (ed.) (2010) *The Times Guide to the House of Commons 2010*. London: Times Books.
- 2 See, for example, two recently published volumes from both sides of the party divide: Kwasi Kwarteng MP, Priti Patel MP, Dominic Raab MP, Chris Skidmore MP and Elizabeth Truss MP (2011) *After the Coalition. A Conservative Agenda for Britain*. London: Biteback Publishing Ltd. and Philpot, R. (ed.) (2011) *The Purple Book. A Progressive Future for Labour*. London: Biteback Publishing Ltd. In both books the subject of occupational pension schemes is treated with near perfect silence.

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