Paper for the BIEN Conference, Dublin, June 2008.

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THE HISTORY AND POLITICS OF THE CITIZEN'S PENSION IN BRITAIN

by John Macnicol

Introduction

Pension systems are notoriously complex and forbidding. This complexity derives to some extent from inherent technical problems - funding mechanisms, eligibility criteria, risk equalisation, and so on - which baffle all except those who work fulltime in the financial services industry. There are numerous problems in designing a state pension scheme that will deliver adequate benefits to future generations, in the face of many unknowns such as life expectancy projections, labour market participation rates and performance of the economy or the stock market. Adding to this inherent complexity is the problem of many vested interests, each with their own agenda. The private pensions industry has always sought to shape state pensions policy in Britain, and successive governments have been over-willing to listen to it.[1] Indeed, the two issues are interlinked: so arcane and forbidding are the mysteries of pension funding that the debate has been dominated by this small group of experts.

[1] Stephen M. Nesbitt, *British Pensions Policy Making in the 1980s. The Rise and Fall of a Policy Community* (1995). For an interesting exploration of the political power of pension funds, see Robin Blackburn, *Banking on Death* (2002).

Good income support in retirement is vitally important. Pensioners are arguably the most economically vulnerable group in modern societies, since their ability to lift themselves out of poverty is very limited indeed: currently, some 2,500,000 pensioners (23 per cent of pensioners) are in poverty. The labour market presents very few offerings to retirees who might wish to return to work, and there is little or no chance of adding to any existing stock of savings. In Britain, the (gender equalised) state pension age is to be raised in stages to 68 by 2046, on the assumption that older people will be fit enough to work a little later in life; however, it is very doubtful whether there are jobs to achieve this.[2] Old age also brings the greatest feminisation of poverty, although this is still insufficiently recognised (the more controversial poverty of families headed by a lone mother being given greater attention). In short, there are many 'under pensioned' people who suffer in old age the consequences of contingencies earlier in life that were beyond their control.

In terms of social expenditure, state pensions are also immensely important, always being roughly half of the total social security budget (which in turn is currently 27 per cent of total public expenditure, and in the past has been over one-third). Britain's pensioner population has grown from 490,000 when state pensions were first paid on 1 January 1909 to some 11,000,000 today. One glance at the incomes of retired households shows how dramatically the welfare state redistributes income to poorer pensioners. The original income of all pensioner households in Britain in 2005/6 (that is, income from earnings, private/occupational pensions, investment income and other sources) averaged £8,490 per annum, and ranged from £1,770 for the poorest quintile to £25,240 for the richest. However, after receipt of cash benefits, deductions of direct and indirect taxes and receipt of imputed benefits in kind, this average rose to a final income of £17,070 per household per annum.

[2] John Macnicol, 'Older Men and Work in the Twenty-First Century: What Can the History of Retirement Tell Us?', *Journal of Social Policy*, vol. 37, no. 3, October 2008 - forthcoming.

Strikingly, the poorest quintile had been raised to £10,560 and the richest to £28,160 - much less of a differential.[3]

A Typology of Pension Schemes

Nevertheless, the inherent complexity of pension funding conceals the fact that pension systems can be categorised quite simply into three types. There can be a degree of overlap, but basically past and present debates on pensions have been built upon the pros and cons of these three alternative models.

First, there is the 'fully funded', actuarially-sound model in which individuals save throughout the lifecourse via a personal account and then receive their 'own' money back in retirement, with accrued interest. There may be some cover for survivors (mainly spouses) and a small element of 'risk-pooling', but the essential principle is one of economic individualism and self-reliance. Such is the basis of many defined contribution, money purchase schemes. On the face of it, there is little state involvement (apart from possibly some tax relief on contributions) and minimal redistribution on lines of class, gender and age. Fully-funded schemes tend to be supported by free market conservatives - for example, by the Adam Smith Institute in Britain via its 'Fortune Account' proposal.[4] It does possess some advantages, most notably a robust contractual entitlement to the pension and an imperviousness to the problems of population ageing (since there is no redistribution between birth cohorts).

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[3] Francis Jones, *The Effects of Taxes and Benefits on Household Income, 2005/06* (Office for National Statistics, 2007), p. 18.

[4] Adam Smith Institute, *Fortune Account. Final Report* (2000)

However, such schemes have enormous inherent disadvantages if made the basis for a state pension scheme. Since benefit levels are strictly linked to contributions, the level of pension that can be accrued by the low paid or irregularly employed (notably women with caring responsibilities) is inadequate. In practice there tends to be considerable supplementation by means-tested social assistance. Minimising risk-pooling also raises the question of what length of survival in retirement should be assumed. It is actuarially challenging, to say the least, to design an individual scheme that can cover both the possibility of survival only one week into retirement and that of becoming a centenarian: the former eventuality would necessitate surplus funds being returned to surviving relatives; the latter would require contributions set at an impractically high level. The question of whether such a scheme, if the basis of state provision, should be voluntary or compulsory is also problematic. If the former, its effectiveness will be undermined by the tendency of the young to see old age as a too-distant contingency not worth saving for. Such behaviour, often dismissed as 'myopic', may be entirely rational, given the pressing claims of other expenditure on those aged in their twenties. On the other hand, state-enforced compulsion undermines the voluntaristic, market basis for the scheme and raises the equally difficult question of whether the state should guarantee fund performance and management. Finally, a fully-funded scheme is politically unattractive, in that it only matures and pays benefits in forty to fifty years' time. In short, it is no vote-winner. Accordingly, contributory state schemes usually begin life with a large 'pay-as-you-go' (PAYG) element and massive taxpayer subsidies, and may eventually end up as completely PAYG. Such was the case with Britain's 1925 and 1946 schemes, as well as that introduced in the USA in 1940.

A PAYG contributory scheme solves this political problem and retains the notion of insurance-based contractual entitlement, thereby eliminating means-testing. Notionally, the pension is 'earned' and deservingness is established by criteria that are impersonally fiscal rather than intrusively moralistic. However, in practice this contractual entitlement is not that robust, since it can be altered by subsequent governments. (There are many historical examples of this). And it is likely that contributors have only the haziest notion of their contractual rights: indeed, the existence of the Pension Forecasting service is a testament to this. The actuarial relationship between contributions and benefits is shrouded in mystery - perhaps deliberately so. A major drawback is that a PAYG scheme throws an economic burden on those of working age when the population is ageing (as was the case in Britain in the 1930s, and will be the case after the second decade of this century). It is also problematic to fund in times of recession and unemployment. In effect, it is a tax-funded scheme but pretends to be a fully-funded contributory insurance one, even though there is no fund accumulating interest. A PAYG scheme can therefore experience the worst of both worlds: even though liabilities are always covered by incoming contributions, its funding is seen as a tax 'burden'. At any one time, there exists only a small surplus of contributions over benefits. This removes the problem of fund performance and management, but it infuses such a scheme with a tinge of dishonesty: 'a lot of tiresome make-believe', was one British civil servant's brutally (but approvingly) accurate comment in 1942.[5] A PAYG scheme also keeps benefits low, since they must bear an actuarial relationship to contributions and, if flat-rate, these must be at a level that the lowest-paid can afford. (Historically, this was precisely its attraction for the Treasury.) Finally, basing eligibility on past contributory record discriminates against those outside the labour market or episodically attached to it: most controversially, a married woman who has spent a lifetime caring can only gain eligibility through her husband's contributions. Notoriously, the 1946 British scheme allowed married women to pay lower contributions: many did so, only to find that their incomes in old age were woefully inadequate.

[5] Edward Hale to Bernard Gilbert, 21 July 1942, National Archives PRO T 161/1164 (S.48497/2).

The third kind of scheme is that under consideration in this paper - a tax-funded scheme paying benefits by virtue of citizenship status (or residence) rather than contributory record. This formed the approximate basis for the 1908 state scheme in Britain, which was a striking example of the basic income principle applied to old age. History supplies us with other basic income proposals which never reached the realm of practical policy - for example, the State Bonus scheme of Bertram Pickard in the 1920s[6] - but the 1908 scheme did, and was examined many years later by planners within the White House when they were working on Nixon's Family Assistance Plan in 1969-72.[7]

Arguably, a tax-funded, non-contributory pension scheme is politically the most honest, in that it does not pretend to be anything other than it is. It is certainly the most radical, redistributing from rich to poor, from men to women (who form a majority of pensioners) and from working-aged to retirees. But it also presents problems. First, citizens must be persuaded to support very obvious income redistribution on line of class, gender and age. This is not an insurmountable obstacle, but it requires a government firmly committed to such redistribution. Second, if introduced as an alternative to an existing contributory scheme, there may be difficult transitional problems regarding ownership of past contributions. Third, an ageing population throws an increasing tax burden on those of working age. Fourth, the residence qualification may be difficult to enforce - a particular problem today, given the extent of international migration. Finally, political realities often require that such a scheme, even if universal in coverage, contains means-testing, so that the small minority of retirees who are relatively wealthy are excluded and a higher pension can be paid to the impoverished majority. However, means testing is stigmatising (thereby

[6] Bertram Pickard, *A Reasonable Revolution* (1919)

[7] Vincent J. and Vee Burke, *Nixon's Good Deed: Welfare Reform* (1974), p. 141.

affecting take-up) and a penalty on thrift (thereby inhibiting saving for old age). Such a scheme must abandon means-testing if it is to be a true citizen's pension, though much the same result can be achieved by stealth via income tax.

The development of pensions in Britain

Far back into history, old age was recognised as a potentially vulnerable stage of life, and many suggestions were forthcoming for its support by the state. In the late eighteenth and early nineteenth centuries, annuity proposals came from Francis Maseres, Thomas Paine, William Pitt and Patrick Colquhoun.[8] However, retirement in the modern sense was confined to a wealthy elite. The main source of support for the aged in Britain was progressively lighter and less well-paid work in the agricultural economy, supplemented by Poor Law outdoor relief which acted not unlike a basic income scheme. Although outdoor relief was officially not supposed to be a Speenhamland-type wage-supplement, Boards of Guardians were empowered to augment 'earnings' - and did so, ignoring the semantic distinction, since this was cheaper than providing full institutional care in a workhouse. Friendly societies did provide sickness benefits which often operated as a quasi-pension for older workers stricken by infirmity, but membership of friendly societies tended to be confined to the skilled working class and overwhelmingly to men.

By the last quarter of the nineteenth century, a variety of factors were worsening the relative condition of old people: population movement from rural communities to towns and cities put increasing pressure on the urban labour market, and simultaneously industry was

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[8] John Macnicol, *The Politics of Retirement in Britain 1878-1948* (1998), pp. 27-8. Subsequent information on the history of pensions is taken from this source.

shedding older workers in the name of improved productivity. Their plight became more visible, and proposals were forthcoming for their support. Essentially, the campaign for old age pensions in the last quarter of the nineteenth century began as a highly conservative movement (with the aim of tightening-up administration of the Poor Law, remoralising the working class male and assisting the exit from industry of older, 'worn-out' workers); but by the 1890s the 'endowment' of old age had become a socialist cause, strongly supported by bodies like the Independent Labour Party and the Social Democratic Federation. The debate from the 1870s to the early 1900s was between proponents of insurance-based, contributory schemes (notably, Canon William Blackley and Joseph Chamberlain) and those who believed that only a non-contributory, tax-funded scheme could alleviate old age poverty (Charles Booth and, later, the National Conference of Organised Labour).

Three notable official committees of enquiry debated contributory versus non-contributory pensions in the 1890s - the 1893-5 Aberdare Commission, the 1896 Rothschild Commission and the 1899 Chaplin Commission - but by the end of the decade contributory pensions were a political non-starter. They would do nothing for the 'bad risks' most in need of income support in old age (women who had spent their adult lives caring, the low paid, the irregularly employed, those who had suffered financial misfortune). It was impossible for the average working class individual to save, since the immediate expenditure claims on working class households were too great. Feeding and clothing one's children took priority. By the 1880s about half of all twenty-five-year-olds could expect to age 65, but past high mortality engendered a deep pessimism about the chances of survival to old age: as one commentator put it, 'can a butterfly even think there is going to be a winter?'.[9]

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[9] Comment by Leonard Courtney, 'Discussion on Mr. Booth's Paper: Enumeration and Classification of Paupers and State Pensions for the Aged', *Journal of the Royal Statistical Society*, vol. lv, pt. 1, March 1892, p. 60.

The 1908 Old Age Pensions Act was in some ways a disappointment to the labour movement, since various exclusion clauses had been introduced in order to limit coverage and hence contain costs (notably, fixing the eligibility age at 70 rather than 65). Yet the radical potential of the Act was considerable, and socialist campaigners were determined to exploit this: being tax-funded and non-contributory, the 1908 scheme redistributed income from rich to poor, from men to women (who formed 62.5 per cent of pensioners) and from working-aged to old people. Married women received a full 5s0d pension in their own right, as citizens. Means-testing was built into the scheme (the pension was reduced progressively on a sliding scale for earnings between 8s0d and 12s0d per week), as were stipulations relating to character (largely ineffective), Poor Law status and, most importantly, residence. There being no retirement condition, it was possible for pensioners to work part-time and have their earnings underpinned by the state: this was quite a significant income-supplement in poorer parts of Britain (notably Ireland).[10]

The aim of many in the labour movement was to whittle away both means-testing and the qualifying clauses, and arrive at a universal, non-contributory pension higher in monetary value and paid at age 60 as part of the 'endowment' of those marginalised from the labour market on grounds of age. As I have argued elsewhere,[11] the concept of 'endowment' was interesting, since it sought for the working class the same automatic right to a basic income that the upper classes enjoyed via inheritance: such an income would be paid at certain times of need (for example, 'motherhood endowment'). Removal of some of the qualifying clauses in 1911 and a hurried doubling of the pension to 10s0d in 1919 seemed to be bringing about the erosion of means-testing. However, a contradiction in the 1908 scheme was that the qualifying clauses were supposed to exclude the behaviourally 'undeserving', yet means-

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[10] Bentley Gilbert, *The Evolution of National Insurance in Great Britain* (1966), ch. 4.

[11] Macnicol, *Politics of Retirement*, op. cit., pp. 138-40.

testing penalised those who had practised virtue by saving for their old age. In the proceedings of the 1919 Ryland Adkins Committee this problem was repeatedly discussed: Was it possible to distinguish between those who had reached old age penniless because of profligate behaviour and those who had done so because of misfortune? Could income from a friendly society sickness benefit scheme be ignored while that from earnings was not? Could different forms of savings be distinguished? The simplest solution was to abolish all means testing and make pensions universal. However, this would make pensions very expensive: if combined with a lowering of the eligibility age to 60 and a raising of the pension to £1 per week (as many in the labour movement wanted), the total cost would be some £214,000,000 at a time when the existing scheme (viewed with alarm by the Treasury) was costing just under £18,000,000.

It was in anticipation of this political and fiscal threat that the Treasury determined to shift the funding of Britain's state pension scheme onto a contributory insurance basis. The story of how this was achieved in the period 1908-25 is complex, and need not be gone into here. Semi-secret civil service planning within Whitehall in the early 1920s (by the Watson and Anderson Committees) merged with the Conservative Party's desire to forge a social reformist 'new conservatism' based on contributory insurance and the 1924 Labour Government's failure to deliver what radicals wanted: Philip Snowden's fiscal orthodoxy resulted in only a slight relaxation of means-testing.

The way was open, therefore, for the incoming 1924-9 Conservative government to implement what the Treasury sought - a partial shift to contributory insurance funding via the 1925 Widows', Orphans' and Old Age Contributory Pensions Act. For a minimum of only five years' contributions, a new contributory pension was grafted onto the 1908 scheme for all covered by National Health Insurance (that is, employees earning less than £250 per annum). The monetary value of the pension was unchanged (10s0d per week), but the qualifying age was lowered to 65, there was no retirement condition and means-testing was abolished. This was something that private pensions providers had wanted, since means-testing - by penalising saving for old age - had threatened their business as well as that of the friendly societies. Significantly, the 1925 Act was designed in close collaboration with an actuary from the private pensions industry - Duncan C. Fraser - and had the effect of boosting occupational pension membership.[12] Abolition of means-testing and the granting of pensions to widows was also a clever and successful political 'sweetener' to legitimate the transition to partial contributory insurance funding (which redistributed within classes, rather than between them).

The 1925 scheme was thus something of an odd hybrid. By a complicated (and quite arcane) mechanism, funding was partially shifted to PAYG social insurance: pensioners henceforth received a contributory pension between the ages of 65 and 70, then moved to the 1908 non-contributory pension but with no means test. Controversially, there was no state contribution but the Treasury had to inject large amounts of taxpayers' money into the scheme in order to grant pension entitlement to all those above the age of 16; the scheme would only have become a fully funded replacement for the 1908 scheme by the early twenty-first century. Significantly, married women not in the formal labour market henceforth received a pension by virtue of their husband's contributions. Most important of all, the Treasury had found a way of insulating the state pension from popular pressure to raise it up to 'subsistence' level. The flat-rate contributory principle could be invoked, utilising the mysteries of actuarial science, to hold down benefit levels.

[12] Sir John Walley, *Social Security: Another British Failure?* (1972), p. 61.

By the late 1930s, however, the Labour Party had come round to accepting the contributory principle as the only way of improving state pensions in an economically cold climate.[13] The existing state pension schemes still required considerable supplementation by social assistance: relaxations in 1940 had increased the number of pensioners claiming such assistance from 250,000 to 1,250,000 - a discovery of latent poverty that shocked many. Beveridge's remit in 1941-2 was essentially to carry out the final phase of the Treasury's long-term plan by merging the 1908 and 1925 schemes into one contributory system and making pensions universal (an important legitimating device). This was justified by a number of ingenious arguments, most notably that it accorded with the spontaneous wishes of citizens: 'Benefit in return for contributions, rather than free allowances from the state, is what the people of Britain desire.'[14] Once again, the economic interests of the private pensions industry strongly influenced policy-making.

Pensions in the postwar world

The complex and rather troubled postwar history of the state pension can be summarised quickly. The shift to complete contributory funding kept the pension level contained, ostensibly on the principle that flat-rate contributions had to be pegged at a level that the low-paid could afford, and this placed an upper limit on the level of flat-rate benefits. Accordingly, there had to be massive supplementation by the National Assistance Board: in 1951, people over state pension age comprised 969,000 out of the 1,460,000 National Assistance claimants (or two-thirds). Beveridge had by no means succeeded in simplifying

[13] National Council of Labour, *Report on Labour's Pensions Plan for Old Age, Widows and Children* (1937)

[14] *Social Insurance and Allied Services*, Cmd. 6404, 1942, p. 11.

matters. Britain still had a multi-tiered pension system: at the bottom, a tax-funded, means-tested system of social assistance for the very poorest; above that, an inadequate contributory pension that failed to combat pensioner poverty on its own; and, at the top, private and occupational pensions for a wealthy minority - though generally offering benefits that only topped up the contributory pension. Postwar pensions policy had not prevented a 'two nations' of rich and poor in retirement.[15]

By the end of the 1950s, some form of earnings-related addition to the state pension was being discussed by both the Conservative and Labour Parties. Labour's plan for *National Superannuation* (1957) was matched by the Conservative government in its introduction of earnings-related supplements in 1961. Once again, the private sector was favourably treated, with occupational schemes being allowed to contract out. State pensions continued to be a major political issue in the 1960s and 1970s. The 1975 Social Security Act introduced the State Earnings-Related Pension Scheme (again, with contracting out), but this was drastically cut back (and nearly abolished) by the Thatcher government in 1986. Most significant of all was that government's decision to uprate the basic state pension only in line with prices. This resulted in the basic state pension falling from 20 per cent of male average earnings in the late 1970s, to 15 per cent in the mid-1990s (which, had it continued unchecked, would have fallen to 6 per cent by the year 2040).[16]

New Labour's approach has been to target the poorest pensioners via Pension Credit and Guaranteed Credit while cautiously formulating plans for long-term pensions reform (with the aid of the Turner Commission). There is to be a restoration the earnings link, a reduction

[15] Richard M. Titmuss, 'Pension Systems and Population Change', in Titmuss, *Essays on 'The Welfare State'* (1958), pp. 56-74.

[16] Paul Johnson, *The Pensions Dilemma* (1994). By the mid-1990s, basic state pensioners had lost about £1000 per annum as a result.

in the number of qualifying years to 30, a simplification of the State Second Pension and a raising of the state pension age over time. However, there will still be a complex, multi-tiered system - means-tested Pension Credit/Guaranteed Credit, the Basic State Pension, the State Second Pension, Stakeholder Pensions, and regulated private provision. In terms of complexity, no progress has been made since the 1930s. The contributory principle can only be sustained with massive social assistance supplementation: currently, 45 per cent of pensioner households are entitled to Pension Credit; even with the current reforms, this will only fall to 30 per cent in 2050.[17]

Current Issues in Britain

Thirty years ago, the idea of a basic income was considered impossibly utopian: postwar advocates of it (like the Conservative MP Sir Brandon Rhys Williams) were marginal to social security debates. Now, however, it receives support for a wide range of opinion - from those on the political left to those on the right who see it as a way of dismantling welfare states.[18]

Likewise, the idea of a citizen's pension has recently been gaining ground in Britain (and the world: forty-six countries now have such a scheme). Strictly speaking, a citizen's pension should be non-contributory only in the sense that it would not be based upon National Insurance contributions: there would still be a substantial PAYG monetary contribution via taxes, and a citizen's past 'contribution' to society would be assumed (whether it be by working, caring, consuming or simply being part of the community). The only qualification

[17] *Source*: Department for Work and Pensions projections.

[18] Charles Murray, *In Our Hands. A Plan to Replace the Welfare State* (2006)

would be residence, perhaps of a certain number of years. This is a potential weakness of the scheme, given modern patterns of migration, the possibility of anomalies or 'hard cases' and problems of accurate record-keeping. The monetary level would have to be higher than the current basic state pension of £90.70p per week for a single person, with married couples each receiving the single rate, and should really achieve a level where there would be no need for Pension Credit (currently, £124.05p for a single person). There would be no means-tests, but those who still received high incomes past state pension age could be subject to 'claw back' by income tax.

Given the confusion that now characterises state pension provision in Britain, and the urgent need to improve pensions, it is perhaps unsurprising that several organisations have swung round to give their support. The National Association of Pension Funds advocates a citizen's pension of £109 per week (2005 level), indexed to earnings, based upon ten years' residence in any continuous twenty years and with single and married women receiving the same pension as of right. However, it would only be payable at age 75, so that the additional cost would be small (another 1.4 per cent of GDP by 2030). Oddly, this version would still be based upon National Insurance contributions - thereby not really conforming to the true citizen's pension model - but qualifying contributions would be lowered from 44 to 20 years. Beyond that, individuals would have to make extra provision via the market, and the NAPF is quite explicit in hoping that its citizen's pension would result in less regulation of the private pensions industry.[19]

Among the main political parties, only the Liberal Democrats have made a citizen's pension official policy. Their version, based upon residence rather than contributory record, would give a pension of £114.05p per week (2006/7) which would in future rise in line with

[19] National Association of Pension Funds, *Towards a Citizen's Pension* (2005)

average earnings; this would be funded by scrapping the State Second Pension and savings on means-tested benefits.[20] However, some individual politicians have expressed an interest. Alan Johnson, when Secretary of State for Work and Pensions, appeared to be supportive in January 2005, and David Willetts MP has declared that the Conservative Party 'will not stand in the way of a citizens pension' - although his preferred option would be to reform the method of collecting contributions.[21] Interest has also been shown by Help the Aged, the Institute for Public Policy Research, the House of Lords and the Pensions Policy Institute.[22]

Conclusion

Britain has the worst state pension scheme in Europe. As a percentage of average pre-retirement gross earnings, Britain's state pension is 30.8 per cent, compared with a EU average of 60 per cent. The levels for comparable countries are: Germany, 35.9 per cent; France, 51.2 per cent; Italy, 67.9 per cent; Spain, 81.2 per cent.[23] Britain's state pension scheme is also one that is riddled with complexity - 'arguably the most complex of any industrialised country', as a House of Lords Select Committee put it.[24] Some sixty-five years

[20] David Laws, Danny Alexander and Matthew Oakeshott, *Reforming UK Pensions: Liberal Democrat Proposals* (2005); Liberal Democrats, *Dignity and Security in Retirement* (2005) and *Pensions Act 2007* (2006).

[21] Patrick Wintour and Michael White, 'Citizens' Pension Plan to Lift Nearly Million Out of Poverty', *Guardian*, 29 Jan. 2005; David Willetts, Speech: 'Modernising the Welfare State: Pensions, Poverty and Property', 13 Dec. 2004, www.davidwilletts.co.uk

[22] See, for example, Alison O'Connell, *Citizen's Pension: Lessons from New Zealand* (Pensions Policy Institute, 2004).

[23] Organisation for Economic Co-operation and Development, *Pensions at a Glance 2007* (2007)

[24] House of Lords. Select Committee on Economic Affairs, *Aspects of the Economics of an Ageing Population: Vol I - report* (2003), p. 45.

ago, similar complaints were being made,[25] and the fact that little has changed in that time would seem to indicate that this long-standing complexity stems from an unwillingness to design and fund a good state pension scheme. In view of this, there is a strong case for a tax-funded citizen's pension built upon the basic income principle as meeting the needs of twenty-first century society. The case can be predicated on the following assumptions:

1. *Retirement is an inevitability in modern industrial economies*. It has been brought about by long-run labour market changes which are irreversible. In 1881, 73.6 per cent of British males aged 65+ were economically active, and by 2001 this had fallen to 7.5 per cent. The trend to male 'early' retirement is likewise a long-run one, beginning in the 1920s, accelerating in the 1930s, reversing in the 1950s and 1960s, and then accelerating again from the 1970s to the early 1990s. Now nearly one-third of people aged between 50 and state pension age are jobless. In essence, the average age of retirement has steadily fallen: whereas in the early 1950s two-thirds of men worked past 65 (though not for very long), now two-thirds have given up work by age 64.[26]

To be sure, the last fifteen years have seen small rises in the employment rates of older people in Britain. For example, 1,175,000 people aged 65+ are now in the labour market, just over 9 per cent of that age group. Although some of this has been the result of choice (facilitated by a tightening labour market), much of it has occurred through necessity (falling money-purchase pension values, the closure of many final-salary occupational pension schemes, a lack of savings). An economic recession could undermine New Labour's bold aim of getting an additional 1,000,000 people aged 50+ back into work and could cause a

[25] W. A. Robson, 'Introduction: Present Principles', in W. A. Robson (ed.), *Social Security* (1943), p. 15.

[26] For a discussion, see John Macnicol, *Age Discrimination. An Historical and Contemporary Analysis* (2006), ch. 3.

further downward movement in employment rates. Of course, older people could be forced into the growing low-paid, hypercasualised sectors of the labour market by more coercive workfare policies. However, the political and ethical question will be whether this is desirable in a civilised society. The scope for increasing the employment rates of older people in the future via well-paid, secure jobs is therefore very limited,[27] and retirement needs to be supported.

2. *People cannot save for their old age*. This has been demonstrated time and time again since the pensions debate took off in the late nineteenth century. At that time, middle-class commentators bemoaned the fact that only a tantalisingly small weekly contribution was required to fund a pension of 5s0d per week at age 65 - little more than the daily cost of a glass of beer, one actuary claimed[28] - yet saving for old age was very uncommon. Indeed, contributory National Insurance pensions were in part a recognition of this reality.

There are now new forces at work which will continue to make saving for old age very difficult. For several years, growth in the British economy has been artificially induced by consumer debt based upon inflated property prices as collateral. Consumer spending has become vital to economic growth. Accordingly, British people now owe £1.34 trillion in mortgage and unsecured debt - slightly higher than the UK's total projected Gross Domestic Product for 2007, by one estimate.[29] The impact on provision for old age has been that there has been little improvement in the propensity to save. Recent estimates of the proportion who are saving adequately for retirement vary between, at best, one half and, at worst, one

[27] Macnicol, 'Older Men', op. cit.

[28] Statement by Reuben Watson, *Report of the Royal Commission on the Aged Poor*, 1895, C-7684-II, Vol. III, *Minutes of Evidence*, p. 621.

[29] Grant Thornton News, 'Press Release: Amount of UK Consumer Debt Exceeds UK GDP', 23 August 2007.

tenth.[30] This is reflected in the incomes from investments obtained by pensioner households: for the poorest 60 per cent of such households, it averages less than £500 per annum per household; for the second-richest quintile it averages £980 per household; and for the richest quintile, it averages £5,410 per household.[31] The Turner Commission calculates that c.9,600,000 people are not saving enough for their retirement.[32] This is unlikely to change in the future. For example, the British university system is being slowly but inexorably privatised, and tuition fees will soon be uncapped. If in the future 50 per cent of 18-30 year-olds go to university, then a large proportion of young adults will be servicing personal debts of £15,000 to £20,000 (£30,000 to £40,000 in the case of a graduate couple) at a time when they are supposed to be buying property, starting families and saving for their old age.

3. *Private or occupational pensions have failed to combat old age poverty*. Despite having been in existence for over a century and a half, they still they provide a meaningful income for only the richest quintile of households. For example, in 2005/06 the average income from private or occupational pensions received by the wealthiest quintile of retired households was £17,730 per annum; the poorest quintile of households received an average of £1,230 per annum, and the average for all households was only £6,230 per annum.[33] In the past ten years, the ferocity of global economic competition has caused employers to do everything possible to reduce production costs, and therefore labour costs. Four out of five final-salary schemes have accordingly been closed to new entrants.[34] In addition, the 1990s

[30] L. Howard, 'Britons "Failing to Save" for Retirement', *Guardian*, 20 June 2007; R. Wachman, R., 'Why Pensions Are Now an Age-old Crisis', *Observer*, 8 April 2007.

[31] Jones, *The Effects*, op. cit., p. 18.

[32] Pensions Commission, *Pensions: Challenges and Choices. The First Report of the Pensions Commission* (2004), p. 159.

[33] Jones, *The Effects*, op. cit., p. 18.

[34] Association of Consulting Actuaries, 'News Release', 11 July 2007.

saw a wave of private pension scandals associated with mis-selling and poor fund management. We can safely conclude, therefore, that private pensions cannot provide adequate income in retirement for the majority of the population. Reform towards a citizen's pension should proceed without consideration of whether it would worsen the fortunes of the private pensions industry, or (as some within the industry suggest) improve them.[35] Arguably, genuflection to the private pensions industry in pensions policy-making over the past century has been counter-productive for the industry's real interests. The massive irony is that it has produced a situation where low contributory benefits have had to be supplemented by massive means-testing, thus weakening the propensity to save for old age.

4. *There will be an increasingly insecure labour market in the twenty-first century, as there was in the nineteenth*. Concepts like 'retirement', 'pensioner', 'unemployment' or 'disability' are really twentieth century constructs arising from the categorisation process in modern welfare states. In the future, with greater labour market insecurity, these categories will become more blurred (as they were in the nineteenth century). Like many industrial societies, Britain is developing an 'hour glass' labour market, with job growth at the top and the bottom. Even more striking has been the slow but massive increase in the number of part-time jobs - from 831,000 in 1951 to 7,560,000 now. Part-time work and self-employment become more likely as cohorts age: thus among men above state pension age, some 66 per cent work part-time and 43 per cent are self-employed.[36] Part-time work by its very nature cannot provide an adequate income and needs to be underpinned by a citizen's pension with no means test and no retirement condition. Again, some five-sixths of part-time

[35] Christine Farnish, quoted in Rachel Stevenson, 'Business Leaders Divided by Compulsory Retirement Age', *The Independent*, 8 Feb. 2005.

[36] Department for Work and Pensions, *Older Workers: Statistical Information Booklet. Quarter Two - (Apr-Jun) 2007* (2007), p. 10.

jobs are performed by women, and therefore existing patterns of employment are not really a viable basis for extending male working lives.

5. *The contributory principle has been a poor mechanism for delivering good state pensions.* Two salutary lessons can be learned from the history of the state pension in Britain. The first is that basing entitlement on deservingness is problematic. Between the 1880s and the 1925 Act, deservingness was defined in relation to certain norms of behaviour. The 1908 scheme attempted to debar certain groups deemed undeserving by their past conduct, and thereby invest the state pension with a status that would distinguish it from Poor Law relief. However, these behavioural conditions proved impossible to enforce. Second, the 1908 Act's means-testing provisions operated in exactly the opposite way by penalising thrift. This contradiction was cleverly exploited by the Conservatives and was used to legitimate the partial shift to contributory insurance funding in 1925.

Some current supporters of contributory pensions (such as Frank Field) offer a similar argument that state pensions should not be based upon the 'something for nothing' principle, and must be a reward for 'having made a contribution'. The fashionable language of conditionality and obligation conceals a workfarist motive. There is no evidence that recipients of the 1908 pension felt pauperised: far from it - they welcomed the pension enthusiastically. All in all, the lesson from history is that basing entitlement on a past contribution to society, whether behavioural or monetary, conflicts with what should be the central aim of pensions policy - the alleviation of poverty in old age. Because the contributory principle was used as a device to keep benefits low, it has resulted in massive means-testing (notionally the very opposite from what it was trying to achieve), which has impacted most severely on vulnerable groups in society. Hence only 24 per cent of women reaching state pension age are entitled to a full basic state pension (though this will change with the current reforms). Means-testing also results in low take-up: some 1,700,000 pensioners do not claim the Pension Credit to which they are entitled, and an estimated £5 billion of means-tested benefits for old people goes unclaimed. Again, although contributory benefits are cheaper to administer than means-tested ones, contracting-out in occupational pensions has proved expensive to administer: one estimate is that 1,500 Inland Revenue staff are need for this.[37] In short, the contributory principle has created a situation where those who most need good income support in old age are least well provided with it.

Conclusion

The year 2008 marks the hundredth anniversary of the original 1908 Old Age Pensions Act, which introduced something like a citizen's pension into Britain. The move away from the 1908 scheme has produced a state pension that is parsimonious, over-complex and riddled with unfairness. It is time to go back to the future.

[37] National Association of Pension Funds, op. cit., p. 35.