Finance for the Future

Making Pensions Work

Richard Murphy

Making Pensions Work

Summary

The UK has a pension crisis. Lots of supposed explanations and excuses have been offered. The general assumption is that it is state pensions that are the cause of our problems. This report challenges that assumption. It shows that the problem in the UK's pension system is not to be found in the state sector, but within our private pension funds.

Using data for the most recent year available – 2007/08 – it shows that total pensions paid in that year amounted to £117.6 billion. Of this sum £57.6 billion was state old aged pensions, £25 billion was state employment related pensions paid to former civil servants and other former public employees and £35 billion was private sector pension payments.

In the same year the total cost of subsidies to the private UK pension industry through tax and national insurance reliefs on contributions made and from the tax exemption of income of pension funds amounted to £37.6 billion. The result was that, albeit indirectly, the entire cost of private sector pensions paid in 2007/08 was covered by tax reliefs given to the private sector pension funds that paid them. To put it another way, every single penny of the cost of UK pension payments in 2007/08 was in effect paid by the UK government.

Understanding this quite shocking fact changes two debates. The first is the pension debate and the second is the debate on the future of state spending in the UK. It's important to stress both points.

A pension subsidy of about £38 billion represents approximately 25% of the UK government's current annual fiscal deficit, 7% of government income and 5.5% of government spending if repeated in the current financial year. To put it in context, this subsidy for private pensions is almost exactly the same as the current UK defence budget. This makes the subsidy given to our pension industry one of the biggest items of state spending in the UK. And yet, to date, no one has asked if it is justified, or well spent, or should continue. In an environment where cuts are being threatened for almost all state spending this is an extraordinary situation.

It is all the more surprising when it is realised that from 1998/99 to 2008/09 pension subsidies to the UK private pension sector cost the UK government £300 billion[i]. To put this in context, in March 2009 total UK government borrowing was £617 billion. In other words, almost half of all UK government debt at the end of 2008/09 had arisen solely because of subsidies given to private pensions over the previous decade. Understanding this changes the deficit debate and yet it has entirely avoided discussion to date[ii].

Simple consideration of these facts leads to the obvious conclusion that the current direction of UK pension reform is wrong. That reform, proposed by Lord Turner and legislated by the last Labour government assumed a world of ongoing economic growth and ever rising stock markets. From 2013

onwards the 56% of people in the UK who currently do not save for a pension will be heavily encouraged to do so through the NEST contributory defined pension scheme that is scheduled to be introduced from that year, with full implementation in 2016. Contributions will amount to 8% of an employees pay – which some have suggested as unaffordable as the state pensions the system is meant to supplement.

It is our suggestion that this scheme is unaffordable because it ignores the fundamental pension contract that should exist within any society. This is that one generation, the older one, will through its own efforts create capital assets and infrastructure in both the state and private sectors which the following younger generation can use in the course of their work. In exchange for their subsequent use of these assets for their own benefit that succeeding younger generation will, in effect, meet the income needs of the older generation when they are in retirement. Unless this fundamental compact that underpins all pensions is honoured any pension system will fail.

This compact is ignored in the existing pension system that does not even recognise that it exists. Our state subsidised saving for pensions makes no link between that activity and the necessary investment in new capital goods, infrastructure, job creation and skills that we need as a country. As a result state subsidy is being given with no return to the state appearing to arise as a consequence, precisely because this is a subsidy for saving which does not generate any new wealth. This is the fundamental economic problem and malaise in our current pension arrangement.

In this paper we set out our evidence that demonstrates the inadequacy of the performance of current private pension funds and we show as a result how misguided it would be to base the future well being of the elderly population of this country on this failed model of pension provision. We do, however, go further by offering recommendations for radical reform of our pension system.

Most importantly we suggest that if those pension funds are to attract tax relief in future they must use a significant part of the £80 billion of contributions they receive each year to invest in new jobs, new technology and new infrastructure for the UK so that the wealth that is needed to grow our economy, to create jobs and to build the real capital base that must be passed to the next generation is built on the back of pension fund investment.

Next we suggest radical improvements in the transparency of pension funds so that all pension investors can hold them to account for the use of the money entrusted to their care – something that is impossible to do at present.

Thirdly, we recommend that current pension deficits in final salary schemes be cleared wherever possible by the issue of new shares in the companies responsible for those funds. This would stop the current fruitless drainage of cash out of companies that should be used for real investment and which is instead directed via pension funds into the stock market to buy shares in other companies, the only benefit of which is to create a spiral of stock exchange boom and bust. We also suggest that future contributions to such final salary pension schemes might also be paid, at least in part, by issuing new shares in the companies responsible for those final salary pension schemes. This would free cash within those companies for real investment in real products and services that create wealth in the UK economy. The benefit of that investment in new products and services would then be shared with the people working in those companies as a result of the mutualisation of their ownership via their pension funds.

Lastly we recommend that if enforced saving is to be required by the government then that government has a duty to ensure that the funds so saved are invested for the common good. Pension fund performance over the last decade has a been a history of almost perpetual loss making despite the enormous subsidies that pension fund tax relief has provided to the City of London and stock markets, all of which they have frittered away. Investment in local authority bonds for local regeneration, or in bonds or shares issued by a new Green Investment Bank and in hypothecated bonds e.g. to provide alternative funding to replace the inefficiently expensive Private Finance Initiative for funding public sector infrastructure projects would have prevented those losses – because all of these would have paid positive returns to pension fund investors. It is for exactly this reason that we recommend that such assets be the basis for any new state pension fund in the future.

The impact of our proposals would be significant. At least £20 billion a year would be released into the UK economy for new investment.

People would understand what their pension funds were doing, and could hold them to account for it.

State subsidies to pension funds would produce real economic returns for the government.

And the incentive to save in pensions would be real – because people would see the benefits of doing so for their immediate well being, for their own future income and for the benefit of their children.

To date pension funds have been an almost perfect example of what Keynes described as 'the paradox of thrift' – saving that sucked demand and well being out of the economy. We need something very different now. We need pension funds that can build economic will being for the present and the future. The recommendations in this report show that sensible reform of pension funds and the tax subsidies they enjoy could make pension funds the engine for economic regeneration in the UK. No reform is of greater importance than that.

The proposals this paper makes are an economically viable, economically reasoned, and ethically motivated solution to one of the biggest problems facing our society in the long term which happens, fortuitously, to provide almost immediate short term benefits for all involved.

Richard Murphy
Finance for the Future LLP
September 2010

Making Pensions Work

1. The conventional view – pensions are a problem, with costly consequences

The UK is reported to have a massive pension problem. It has a booming population of people of retirement age[iii]. Its private sector pension funds are in parlous shape[iv]. Its state funded pensions are supposedly unaffordable[v]. Its population has not, it is said, saved sufficiently to fund their old age[vi]. The consequence is that the age of retirement is increasing – to 66 soon, with the upward trend to continue. This will cut the cost of paying state old age pensions. In addition, from 2013 onwards the 56% of people who currently do not save for a pension[vii] will be heavily encouraged to do so through the NEST contributory defined pension scheme that is scheduled to be introduced from that year, with full implementation in 2016[viii]. Contributions will amount to 8% of an employees pay – which some have suggested as unaffordable as the state pensions the system is meant to supplement[ix].

2. Claims made about the crisis

Some of the reasons for the current crisis in pension provision in the UK are inherent in the definition of the problem noted above. Most especially, people are living longer and the trend appears to be ongoing, at least for the time being[x]. And there is, whether by political choice or not, significant pressure on the funds available to pay state pensions[xi].

But these are not the only reasons given by many for the crisis we now have. Others are offered, including the collapse in confidence in private pensions following the failure of Equitable Life and the refusal of the last Labour government to pay significant compensation as result[xii]. The misspelling of personal pensions in the 1980s and early 1990s did not help either[xiii]. But most especially, the change in the tax laws Labour introduced in 1997 so that the tax credit on pensions received by pension funds was eliminated, reducing the income of funds by about £5 billion a year at the time, has been blamed extensively by Conservative politicians and their allies for the sorry state of private pension funds ever since that time[xiv]. In particular, some suggest that this is the reason for wide scale closure of final salary pension.

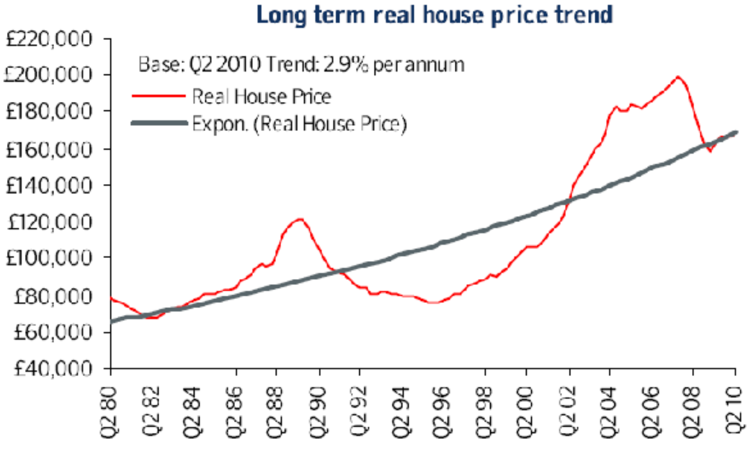
3. Better explanations of the crisis

The reality is whilst that the cost of an aging population is a reason for the pension problem, most other explanations noted above (and others offered elsewhere, not noted here) are at best partial explanations of the problems we face.

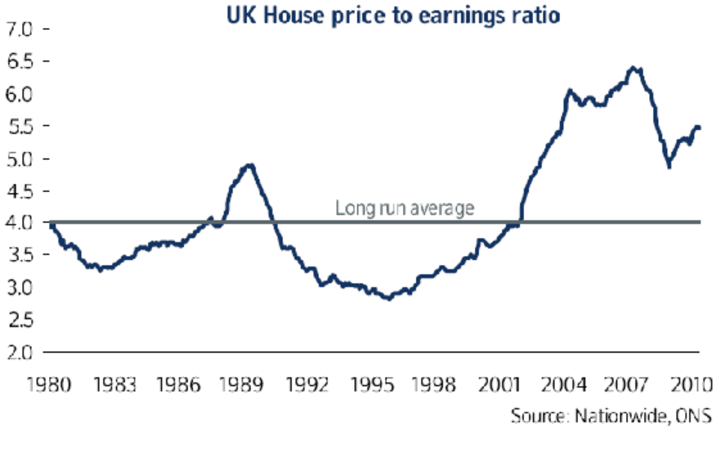
Of course it did not help confidence in the pension system that so many people were mis-sold pensions under plans promoted by Conservative governments in the 1980s. And of course it did not help that a major and trusted pension company failed so many pensioners with the government refusing to accept some responsibility for the issue. It is, however, too simplistic to blame the issue solely on such causes.

It is also completely misleading to blame a change in tax law for the collapse of final salary pension schemes. Alex Brummer in his book 'The Great pensions Robbery' claims (page 65) that the impact of this change cost the industry about £100 billion in the first decade it had effect, but in 2010 pension fund investments amounted to more than £900 billion[xv] and annual contributions exceeded £80 billion[xvi]. The impact of the tax change was undoubtedly a loss to pension funds, but the reality is that it was not of the scale indicated by those who have sought to create political capital from it and that change in the law could not have created the current pension crisis.

There are other real issues that have contributed more to the crisis but which have gone largely unnoticed. One has been increasing house prices meaning many people have been forced to invest in their property and not in their long term future. This graph[xvii] shows the trend in house prices quite dramatically, the term 'expon' relating to the 'exponential' or average trend over time:

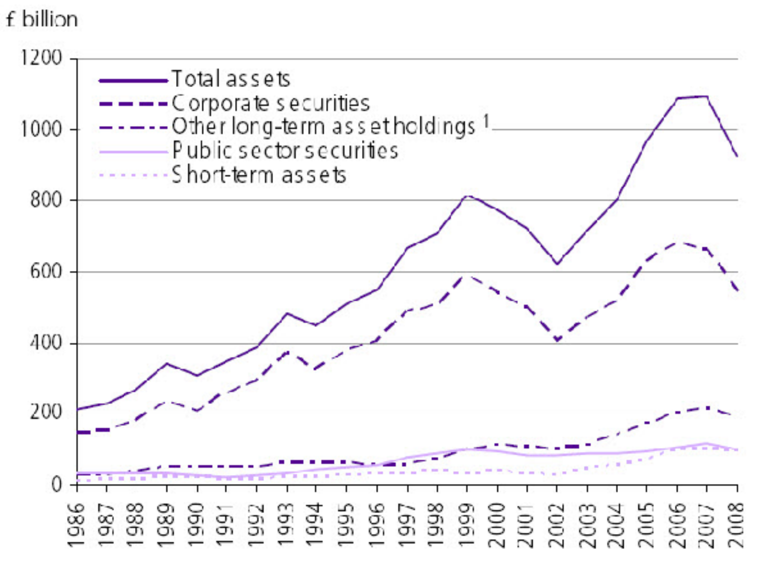


This next graph, also from the Nationwide Building Society, shows the ratio of UK house prices to average earnings, and explains the resulting misallocation of savings resources to domestic housing:



Cash has, perforce, been saved by many in land and buildings, not pension funds.

Many have, however, thought this savings decision, to reject pension funds in favour of land and buildings a rational choice. As data published by the organisation promoting the City of London, TheCityUK, shows[xviii], the ten year rate of return on investment in UK stock markets was an average loss of 2% per annum over the first decade of the twenty first century. This was also the global average rate of return on shares in that decade. The US market did worse, averaging a loss of 3% per annum over the decade and yet pension funds resolutely stuck to share based investments when investing on behalf of their members, as this graph of trends in UK pension fund investments over the period shows:



1 Other long-term asset holdings comprise overseas government securities; loans and mortgages; fixed assets; holdings in insurance-managed funds; property unit trust holdings and other UK or overseas asset holdings.

Source: National Statistics[xix]

Around 60% of pension assets are still saved in corporate securities, the only notable change of late being a shift from shareholding to private sector bondholding within this category. Government bonds are, of course, part of public sector securities.

The persistent purchase of shares by pension funds when the market was paying no return cannot have encouraged potential savers to entrust their assets to pension fund managers, and this has no doubt contributed to the low pension savings rate the UK has witnessed.

It also undoubtedly contributed to the deficits those pension funds suffered. Whilst the sums they control appear vast, amounting to £915bn in March 2010 according to the Pension Protection Fund[xx] the liabilities they owed at that date were of equal amount, and it was to very large degree pure luck that this equation balanced at that time since this was a massive improvement on the situation a year before when the stock market crash meant there had been a 22% overall deficit in the UK's pensions funds – totaling £242 bn in all. Such volatility has not inspired confidence, and there is no reason why it should in future.

4. Tackling the real causes of the crisis

Important as these issues are though, this briefing shows that whilst there is some relevance to these better explanations for the crisis they too cannot explain the dilemma we face. That is because the UK's pension problem is, we argue, quite different from that which is conventionally diagnosed based on these facts. Our alternative view is that the UK's pension problem is that far from the state sector pension being the cause of all our current problems and the private sector being the solution to our pension dilemma it is, in fact the private sector pensions that have failed to deliver to date, and that without the state we would already be deep in a pension crisis.

This argument is backed by facts. Based on data from HM Revenue & Customs, Office for National Statistics and the pension industry in 2007/08 – the last year for which comprehensive data is available - total pensions paid in the UK amounted to £117.6 billion. Of this sum £57.6 billion was state old aged pensions; £25 billion was state employment related pensions paid to former civil servants and other former public employees and £35 billion was private sector pension payments. Full data is supplied in appendix 1 to this report. The consequence of this is that £82.6 billion of this cost arose directly to the UK government and the balance, apparently, to private pension funds.

5. All pensions in the UK are being paid at direct cost to the UK government

However, the situation is more complex than that. As we also show in appendix 1, the cost of state subsidies for pensions in the same year, 2007/08 amounted to £37.6 billion. In other words, the entire cost of all supposedly 'private' pension scheme payments made in that year also fell on the UK government as well. What that means is that all pension payments in the UK in that year were made at direct cost to the UK government and none at all, in effect, at cost to the private sector pension industry.

Of course the link is not direct: the subsidies given to companies and individuals to encourage them to make contributions to pension funds and the direct subsidies the pension funds received themselves, either on contributions paid to them or by receiving their income tax free, were not directly tied to the pensions those funds in turn paid out. We also know that notionally some of the tax relief given to employees on pension contributions goes to those who appear to contribute to state 'pay as you go' pensions schemes – but only because they have to enjoy a comparable relief to that which goes to those making contribution to private sector funds to ensure that the latter appear attractive savings mechanisms. The result is that even this subsidy effectively supports those private sector funds.

With these points being noted, we argue that what the data we present shows is that without these subsidies to those making contributions and those direct subsidies paid to the funds themselves then the position of those funds and their capacity to make pension payments would have been severely, if not completely undermined. In other words those funds do, directly or indirectly enjoy the entire eventual benefit of the tax subsidies that we summarise in this paper, and in that case the entire pension income that private pension funds paid out in 2007/08 was covered by subsidies they received, directly or indirectly from the UK government.

6. Should private pensions get £38 billion of government subsidy a year?

Appreciating these facts completely changes the pension debate as well as the current debate on the use of government funds in the light of the current fiscal deficit that the UK government faces. After all, this subsidy is, in effect state spending by any other name and yet it appears to have been completely excluded from the cuts debate.

A pension subsidy of about £38 billion represents approximately 25% of the UK government's current annual fiscal deficit, 7% of government income and 5.5% of government spending if repeated in the current financial year. To put it in context, this subsidy for private pensions is almost exactly the same as the current UK defence budget. This is no small sum when cuts are being considered and yet it is one that has entirely avoided debate[xxi]. It has to be asked whether such sum can be justified.

7. What are private pension funds doing?

In the light of this evidence it becomes reasonable to ask what private pension funds are actually doing to justify the subsidy they receive when it seems that they are largely ineffective at delivering pensions to their members without the cost of doing so being covered by a subsidy from the state. This is, of course, a completely different question from that asked by all pension enquiries to date, which have assumed that the private sector can deliver pensions and that the state sector cannot, evidence that our data now challenges.

To put it another way, how can an industry that has £80 billion or so of money invested in it each year apparently require an enormous state subsidy to ensure it pays a return? We suggest that there are two core reasons for this failure of private pension funds to deliver for their members and the UK government.

First, the mismanagement of the investments they hold has been of extraordinary scale when compared to the obligations such funds have to meet. For example, in February 2010 BT Group Plc revealed it had a £9bn pension deficit when at the time it had a market capitalization of about £10 bn[xxii]. In effect this company is being swamped by its pension liabilities. The chance that company has of being able to innovate its way out of this situation by making new investments is remote in the extreme: the demand on its cash flow to fund pension obligations denies it that opportunity.

This though is the 'micro' perspective of the problem. Adopting the alternative 'macro perspective offers the second reason for private sector pension fund failure. This is the consequence of there being no obligation on those funds to invest in a way that creates new economic activity. As was demonstrated at the time of a previous pension crisis[xxiii], 99% of all investment in corporate shares and bonds made by pension funds is in what might best be called "second hand" shares or bonds already in issue. The purchase or sale of such shares or bonds provides the issuing companies nominally responsible for these assets with no direct benefit at all from their purchase. It was of course true that when first issued such shares and bonds would have provided funds to the company that issued them, and whose name they bear, but thereafter whenever they are bought and sold – as they are day in, day out by pension funds – not one penny of the money traded goes to the benefit of that company. Instead all of it goes to the previous owner of the share or bond in question. That may be a pension fund, of course, but the point is that none of this speculative activity does in any way benefit the productive economy. As such a pension funds purchase of these assets creates no new investment or employment opportunities. In economic terms these pension fund "investments" are, therefore, savings activities and not investment activities.

In contrast only about £100bn, or about 12% at most, of pension fund holdings are in government securities. This represents a considerable investment portfolio imbalance which fails to reflect the proportionate roles the state and private sectors each play in the economy when the state as a whole accounts for more than 40% of GDP.

This investment profile has, we argue, enormous impact at this time of economic crisis. In effect pension savings are currently receiving a state subsidy to suck demand out of the economy – where it is needed to boost economic activity – so that the cash in question can be placed into savings - where no productive activity results. Pension saving is, therefore, at this moment, increasing the recessionary cycle, and not decreasing it.

The result is that the enormous and unquestioned tax subsidy that our pension industry is receiving is at this moment depressing our economy when that is the last thing we need to happen.

8. Inadequate reform

Faced with a problem of this scale the currently proposed pension reforms for the UK, based on the Turner Report of 2005, which was written against a background belief that a booming economy could last forever, appear hopelessly outdated.

Those proposals require that all employees make payment into a funded pension scheme. They would, of course, enjoy tax relief when doing so, but the pension funds in question would, it was then assumed be saved as have all private sector pensions funds to date, in the ways noted above. Importantly, Lord Turner did not place obligation on the managers of these funds to actually use the funds entrusted to their care to regenerate the economy by being invested in new economic activity rather than being used for speculative purpose. This was a major omission in his report, revealing the inadequacy of its fundamental economic analysis.

9. The fundamental pension contract

This is, in the light of the evidence noted above, the wrong direction for reform. The reform of pensions required at this time must be based upon recognition of the fundamental pension contract that exists within any society. This is that one generation, the older one, will through its own efforts create capital assets and infrastructure in both the state and private sectors which the following younger generation can use in the course of their work. In exchange for their subsequent use of these assets for their own benefit that succeeding younger generation will, in effect, meet the income needs of the older generation when they are in retirement. Unless this fundamental compact that underpins all pensions is honoured any pension system will fail.

This compact is ignored in the existing pension system. Indeed, the current pension system does not even recognise that it exists. Whilst state subsidised saving for pensions is undoubtedly taking place there is no link between that activity and necessary investment in new capital goods, infrastructure, job creation and skills. As a result state subsidy is being given with no return to the state appearing to arise as a consequence, precisely because this is a subsidy for saving which does not generate any new wealth. This is the fundamental economic problem and malaise in our current pension arrangement.

In the meantime, and as importantly, a massive but unproductive industry in managing pensions funds has been created, which enormously reallocates wealth to the City of London but which appears unable to pay any adequate pension returns.

10.The economic consequence of pension failure

This whole arrangement has enormous cost to society at large. At a time of recession this is especially important: the current pension industry reinforces what Keynes called the paradox of thrift[xxiv], draining enormous sums out of the economy and into saving (but not then on into investment) at a time when a redirection of the flow is needed i.e. money needs to go into the economy to create investment, jobs and future well being which can underpin future pensions.

A redirection of this flow, so that pension savings are transformed into pension investments is the necessary economic basis for pension reform.

11.The reforms that are needed

Seven reforms are needed.

Firstly, the state has to guarantee an old age pension that keeps all older people in this country out of poverty irrespective of their fortunes during their working life, their gender and their relationship status. This means a commitment to increasing the basic pension and enhancing pension credits is essential.

Second, if tax relief is to be given to pension fund contributions then there must be conditions attached to doing so. To secure this tax relief in future we recommend that a significant part of those pension fund contributions (we suggest at least 25% of them, and maybe more) must be invested in new economic activity and not in the buying and selling of shares and bonds which provide no new money for the real economy. This means pension funds must be proactively used to create new capital assets, infrastructure, skills and job. In addition, pension funds must be required to invest for the long term and to minimise the transaction costs at present paid every time a stock or bond is bought or sold. This means that funds should be required by law to invest strategically as business partners and not speculatively for short term gain, a role that is in any case and inevitably in conflict with their long term duty to produce returns for their members. Of course, we accept that some pension funds will not want to invest in the way we recommend. They must be allowed that choice so long as they clearly understand the corollary that there would be no tax relief for those choosing to invest in them.

Thirdly, the process of pension fund saving must be seen to be invested in the inter-generational pension contract explained above. To ensure that this is the case pension funds must be accountable to those who either voluntarily or compulsorily save for their old age through a pension fund. As such pension funds must be required to produce accounts that are comprehensible to a lay person, must supply them to all members, and must in those accounts detail their investment programmes and the opportunities those investment programmes have created in the areas where the members they serve live.

Fourth, in pursuit of these objectives pension funds must seek to undertake new forms of investment. It is very obvious that the existing profile of their 'investments' (which are actually savings) carry inherent speculative risk which makes them unsuitable for long term pension saving purposes whilst providing considerable opportunity for excessive charges to be made by the City of London, which is contrary to fund member's best interests. If pension funds were instead genuinely invested in local authority bonds for local regeneration, or in bonds or shares issued by a new Green Investment Bank and in hypothecated bonds e.g. to provide alternative funding to replace the inefficiently expensive Private Finance Initiative for funding public sector infrastructure projects then this situation would be changed, quite radically. What is more these alternative investments would not only create jobs in the UK economy, they would also have life spans that will suit the needs of many pension fund managers and their members because the investments will earn revenue over periods of up to twenty five years and more before returning capital when required by pension funds to provide annuities.

Fifthly, existing pension fund deficits need to be addressed to ensure members' well being is not at risk. The existing mechanism for doing so is to require the fund's sponsoring corporation to inject more cash which is then used to buy shares in other corporations. This, however, simply helps creates a boom and bust cycle in share prices whilst denying cash to necessary investment in real business activity. In addition this pension topping up is treated as a cost by the sponsoring company, which depresses businesses earnings and tax revenues (through the additional tax relief that such topping up attracts), both being contrary to the best interest of the fund's members. The obvious mechanism that will stop this destructive cycle of cash injections that never fill the apparent pension deficit, but which do boost City well being, requires the sponsoring company to issue its pension fund with shares in itself to the value needed to eliminate the pension fund deficit. The pension fund will then, of course, be allowed to issue these into the market over time, if it so wishes.

It is stressed that this will not be detrimental to the company. The shares issued to the pension fund will clear the deficit in the pension fund – which would otherwise be shown as a liability in the company's accounts. Under our proposal that liability is cleared and its capital is increased at the same time. The company's balance sheet is stronger as a result of this share issue. The value of the shares held by those holding shares before the pension deficit is cleared by the issue of new shares to the pension fund should not be affected either: the new shares have a value exactly equivalent to the liability cleared, so the company's worth should have gone up by the value of the shares issued – leaving existing shareholders as they were, but for one thing, which is bound to leave them better off. That difference is that the company will now have free cash flow to invest in new opportunities – from which it would profit, instead of having to devote that cash to shoring up its pension fund in a never ending, and always failing, game of trying to beat the stock market.

As a result such a policy would provide the business that currently has a pension deficit with the essential cash it needs to invest in its own business to ensure it continues to grow and support jobs whilst clearing that deficit will not distort that company's reported cash earnings, leaving the company vulnerable to takeover, and it will not reduce tax revenues, but it will at the same time recognise the legitimate claim employee's now have on the capital of their employers.

Sixthly, the method of paying future fund contributions has to be reconsidered. Of course cash is one mechanism for making such contributions, but active consideration should be given to payment of contributions by employers in kind by issue of new shares in their companies to their pension funds, which would then be at liberty to dispose of them, if they wished. Of course there are problems with any pension fund being too over-exposed to investment in the company that promotes it, as Enron proved, but subject to this caveat such a process ensures pensions can be funded without denying cash to businesses that want to provide final salary pension schemes.

Finally, if the government is to require compulsory saving for old age then that saving should not be directed towards the casino structure of the stock exchange but must instead be invested in stable, secure and predictable investments including government gilts and a mix of the new investments described in the fourth recommendation, above. It is not the duty of the government to require that any person compulsorily put their savings at risk. This requires a review of the structures proposed by Lord Turner before they are implemented with potentially serious consequences.

12.The impact of the changes

The changes we propose would have a number of profound effects which would quickly become apparent within the real economy.

Firstly, a commitment to enhancing the state pension is part of the fabric of a good society.

Second, if pension funds are required to invest and not be used for speculative purchases of previously issued shares and bonds then at least a significant part of the £80 billion of funds entrusted to them each year would rapidly become the biggest source of new investment funding in the UK, transforming their role and ensuring the biggest boost to investment in the economy for generations. We suggest that at least £20 billion a year will be made available for new investment in the UK economy as a result of this change, transforming the role of our pension funds and transforming the prospects for the UK economy at the same time.

Thirdly, making pension funds accountable through better reporting would remove one of the current obstacles to pension investment, which is the current quite rational reaction to the fact that funds once committed are now almost wholly lost from view with no certain prospect of ever producing a return because of quite reasonable doubt many have about how the funds are being used by the pension trustees. Pension fund accountability would, inevitably, transform pension fund behaviour when at present they are almost entirely opaque.

Fourthly, if pension fund investment was better understood and some pension funds offered clear regional investment profiles so that those saving in them could know the funds they were putting aside for their old age were being used in the meantime to create local jobs in the communities in which they lived then a current major objection to this form of saving – which is that the pension saver has no idea what is being done with their money - would be eliminated.

Fifthly, the widespread and rational feeling that pension fund savings are abused by the City who profit at expense of pension fund members will be brought to an end, because the change in pension fund objectives will bring that abuse to an end. This will help deflate the predominant role of the City in society.

Sixthly, employee co-ownership of their business through their pension funds will become more commonplace. This is now widely seen as a successful business model.

Seventh, government funding will be better targeted to ensure favourable, broadly based outcomes for society rather than being focused on a restricted range of individuals enjoying pension premium tax relief.

Finally, and hopefully, the return to pensioners should improve as succeeding generations receive from them the capital and infrastructure inheritance they need to ensure they can keep their forebears in their old age.

As such this is an economically viable, economically reasoned, and ethically motivated solution to one of the biggest problems facing our society in the long term which happens, fortuitously, to provide almost immediate short term benefits for all involved.

Appendix 1 – pension data for 2007 /08

In the financial year 2009/10 UK state pensions cost the Exchequer £66.8 billion[xxv]. In combination that was 54.1% of all administered by the Department for Work and Pensions (totaling £123.3 billion)[xxvi] and amounted to almost exactly 10.0% of all government spending[xxvii] and 4.8% of UK estimated GDP[xxviii]. The equivalent figure for old age pensions in 2007/08 was £57.6 bn[xxix]. This however, is not the whole story when it comes to the cost to the state of pension provision. When the full story is told the situation is much more complex.

To put this in context, in 2007/08 (the latest year for which comprehensive data is currently available) HM Revenue & Customs record that income from all “other pensions” (i.e. pensions other than state old age pensions) declared on tax returns amounted to £60 billion[xxx]. This figure is somewhat bigger than the figure calculated by National Statistics for total pension fund payments in that year, which amounted to £35 billion (plus an additional £6 billion of very largely tax free lump sum payments made on retirement which are therefore not reflected on tax returns)[xxxi].

The reconciliation between total “other” pension income of £60 billion and the sum paid by private pension funds must, of course, be made up of the unfunded, pay as you go, state pensions paid as a result of accrued employment rights. These arise, for example, for members of the civil service who work for the state and who nominally contribute part of their salary to a pension fund as a consequence, but where the state does not actually invest these funds but does instead use them to pay the pensions of those already in retirement – hence the term ‘pay as you go’. The total of these pension payments, by deduction, amounted to approximately £25 billion in 2007/08. As a proportion of GDP this is 1.7%, a number confirmed to be correct by the National Audit Office[xxxii].

A summary of pensions paid in 2007/08 is, therefore, as follows (within reasonable parameters of calculation):

Type of pension	Sum paid £’bn
State old age pensions	57.6
Private sector pensions	35.0
State employment related pensions	25.0
Sub-total, pensions paid	117.6
Private sector, lump sums	6.0
Total pension returns, including lump sums	123.6

Of this sum £82.6 billion appears to be paid directly by the state and £41 billion by the private sector of which £6 billion is not treated as income for tax purposes.

It may also be worth noting that National Statistics additionally calculated that pension funds spent £5 billion on administration and costs in 2007/08, bringing the total cost of paying taxable pensions of £35 billion to £46 billion in the year[xxxiii].

It is then important to note that in the same year, 2007/08, the total sum paid by companies and individuals into pension funds amounted to £83.1 billion[xxxiv]. The total tax relief given on these contributions cost HM Revenue & Customs £37.6 billion in the year in question[xxxv]. This is made up as follows[xxxvi]:

Relief for	2007-08 £ billions
Occupational Scheme Contributions	
By Employees	4.4
By Employers	13.2
Personal Pension Scheme Contributions	
By Employees	2.1
By Employers	2.0
PP and RAC Contributions by self employed	1.3
National Insurance rebates to PPs	0.1
Tax free investment income of funds	5.9
Lump sum payments from unfunded schemes	0.4
National Insurance relief on employer contributions	8.2
Total	37.6

As is clear from this data – a belief in private pensions as the basis for future provision looks forlorn because even in their good years (which may now be over) they appear to have supplied only £35 billion of ongoing pension payments (at most) out of a total of £117.6 billion of total pension payments, or less than one third of pension payments. And they did so at a total cost to the state for pension tax relief of £37.6 billion.

Putting this data together does suggest that the total cost to the state of paying pensions is:

Cost	Sum paid £'bn
State old age pensions	57.6
State employment related pensions	25.0
Cost of pension tax relief in addition to the above	37.6
Total	120.2

In other words, and allowing for inevitable rounding in all estimates of this sort and the fact that these ratios are bound to change a little from year to year, every single pension payment made in

2007/08, totaling £117.6 billion in all (if lump sums are ignored) was made at eventual direct cost to the UK government, even if not paid directly by it. The private sector did not, in effect, bear any of the burden in that year of paying pensions to members of private sector pension funds. Those private pensions were, in effect, paid entirely out of the state subsidies that the pension industry or those making pension contributions (whether as employer or as employee) received, directly or indirectly.

Appendix 2 - About Finance for the Future

Finance for the Future is a partnership between chartered accountant Richard Murphy and environmentalist Colin Hines.

Richard Murphy is also the director of Tax Research UK and founder of the Tax Justice Network and a regular blogger on tax reform at www.taxresearch.org.uk/blog.

Colin Hines is the creator and convener of the Green New Deal group.

Together Richard and Colin have worked on the Green New Deal, the promotion of local authority bonds and pension reform, all with the objective of releasing funding for green investment in the UK.

Financial support for the research undertaken to produce this briefing from the Network for Social Change and the Joseph Rowntree Charitable Trust is gratefully acknowledged but the report remains the sole responsibility of Finance for the Future LLP.

Contact Information

Finance for the Future LLP

The Old Orchard, Bexwell Road, Downham Market, Norfolk, PE38 9LJ, United Kingdom

+44 (0) 1366 383500
+44 (0) 777 552 1797

www.financeforthefuture.com
rm@financeforthefuture.com

Registered at the above address. Registered number OC329502

Endnotes

[i] From http://www.hmrc.gov.uk/stats/pensions/table7-9.xls accessed 22-9-10

[ii] All based on http://www.hm-treasury.gov.uk/junebudget_diagrams.htm

[iii] The number of people of state pensionable age is projected to increase by 7.2 per cent from 11.3 million in 2006 to 12.2 million in 2010. Allowing for the change in women's state pension age between 2010 and 2020, the population of pensionable age will then rise more slowly, reaching 12.7 million by 2020. A faster increase will then resume, albeit one now expected to be tempered by the increase in state pension age for both sexes from 65 to 66, but with the number over pensionable age still likely to reach almost 15 million by 2031 http://www.statistics.gov.uk/pdfdir/pproj1007.pdf

[iv] Whilst the sums they control appear vast, amounting to £915bn in March 2010 according to the Pension Protection Fund the liabilities they owed at that date were of equal amount, and it was to very large degree pure luck that this was a massive improvement on the situation a year before when the stock market crash meant there had been a 22% overall deficit in the UK's pensions funds – totaling £242 bn in all. Any future volatility in share values will return those funds to periods of deficit again. http://www.peoplemanagement.co.uk/pm/articles/2010/04/private-sector-pension-schemes-back-into-aggregate-surplus.htm

[v] This could be said to be the whole argument for the Turner Report. It could also be summarised as the whole reason why its implementation has been so difficult. And it is the reason for increasing g the state retirement age. See, for example, http://www.guardian.co.uk/business/2006/apr/04/politics.turnerreport and http://www.guardian.co.uk/money/2010/jun/24/state-pension-age-rise-66

[vi] See for example http://www.telegraph.co.uk/finance/personalfinance/pensions/7858853/Women-over-50-not-saving-enough-for-pension.html

[vii] Turner Report quoted in Brummer, A 'The Great pensions Robbery', page 151

[viii] For more information on current plans, which may be subject to change, see http://www.timesonline.co.uk/tol/money/pensions/article6981820.ece

[ix] See for example http://www.thirdsector.co.uk/channels/Finance/Article/1026256/Actuaries-warn-unaffordable-compulsory-pensions-bill/

[x] Data on this issue is noted by David Willets in his book 'The Pinch' e.g. page 240.

Additionally note that it is now 65 years since the end of World War 2. Those born soon after servicemen and women returned from that war are now retiring and for the next twenty years people will be retiring in greater numbers than ever before. The result is that the number of people of state pensionable age is projected to increase by 7.2 per cent from 11.3 million in 2006 to 12.2 million in 2010. Allowing for the change in women's state pension age between 2010 and 2020, the population of pensionable age will then rise more slowly, reaching 12.7 million by 2020. A faster increase will then resume, albeit one now expected to be tempered by the increase in state pension age for both sexes from 65 to 66, but with the number over pensionable age still likely to reach almost 15 million by 2031. http://www.statistics.gov.uk/pdfdir/pproj1007.pdf

[xi] See for example http://www.telegraph.co.uk/finance/economics/7812458/Benefits-and-pensions-targeted-to-cut-deficit.html

[xii] For the latest twist in this sorry tale see http://www.guardian.co.uk/money/2010/sep/06/equitable-life-last-ditch-compensation-call

[xiii] See Alex Brummer, 'The Great Pensions Robbery' Chapter 3

[xiv] David Willets and Alex Brummer both discuss this extensively in books already noted, above.

[xv] http://www.peoplemanagement.co.uk/pm/articles/2010/04/private-sector-pension-schemes-back-into-aggregate-surplus.htm

[xvi] http://www.statistics.gov.uk/cci/nugget.asp?id=1283

[xvii] http://www.nationwide.co.uk/hpi/historical/Jul_2010.pdf

[xviii] http://www.thecityuk.com/media/182038/equity%20markets%202010.pdf

[xix] http://www.statistics.gov.uk/downloads/theme_compendia/pensiontrends/Pension_Trends_ch09.pdf

[xx] http://www.peoplemanagement.co.uk/pm/articles/2010/04/private-sector-pension-schemes-back-into-aggregate-surplus.htm

[xxi] All based on http://www.hm-treasury.gov.uk/junebudget_diagrams.htm

[xxii] http://ftalphaville.ft.com/thecut/2010/02/12/147791/bt-dives-on-pension-deficit-disclosure/

[xxiii] http://www.neweconomics.org/publications/peoples-pensions

[xxiv] http://en.wikipedia.org/wiki/Paradox_of_thrift

[xxv] http://www.official-documents.gov.uk/document/hc1011/hc02/0296/0296.pdf note 15

[xxvi] http://www.official-documents.gov.uk/document/hc1011/hc02/0296/0296.pdf page 49

[xxvii] HM treasury budget data

[xxviii] HM Treasury

[xxix] http://www.dwp.gov.uk/docs/report-2007-08.pdf note 16a

[xxx] http://www.hmrc.gov.uk/stats/income_distribution/3-6table-jan2010.pdf

[xxxi] http://www.statistics.gov.uk/downloads/theme_compendia/pensiontrends/Pension_Trends_ch09.pdf

[xxxii] http://www.nao.org.uk/idoc.ashx?docId=2fadc187-720d-49a0-a290-442e7e67454e&version=-1

[xxxiii] ibid

[xxxiv] http://www.statistics.gov.uk/cci/nugget.asp?id=1283

[xxxv] http://www.tuc.org.uk/pensions/tuc-16929-f0.cfm. Note the ratio is more than 40% because of the combination of income tax, corporation tax and national insurance reliefs.

[xxxvi] http://www.hmrc.gov.uk/stats/pensions/table7-9.pdf