THE REFORM OF PENSIONS IN THE UK

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1. Introduction

The UK pension system and the scale of the potential ageing problem facing the UK are quite different from those in most European countries. The scale of ageing to be faced over the next fifty years is less than in many countries and the future cost of pensions relatively even lower. The private sector already plays a central role in pension provision and its relative role has been increasing due to policy changes in the 1980s. More than three quarters of the working population are covered by some form of private scheme, and even among current pensioners only around half of their income comes from the state – although this proportion is much higher for those at the bottom half of the income distribution.

The purpose of this paper is to explain the nature of the reforms that have transformed the UK pensions system in the decade and a half after 1980 and to start providing an assessment of those reforms. We begin with providing a brief outline of the history of the UK pension system and a description of how it stands in 1996, before examining the nature of the reforms carried out, what they were intended to achieve and to what extent they have been successful.

1. The UK pension system

State pension provision in the UK dates back to the Old Age Pension Act of 1908 which introduced a system of non-contributory, mean-tested pensions for the over 70s. Contributory pensions were first introduced in 1925 and extended and strengthened in 1948 following the implementation of the Beveridge Report (1942). The state pension is available to men of 65 years or older and women of 60 or older.

The state pensions thereby introduced were never intended to be much above a subsistence level and were paid at a single rate – not related to earnings levels or employment history. Throughout the post war period the level of the basic pension has not been much different from the minimum mean-tested income available from the state (successively National Assistance, Supplementary Benefit Income Support). In 1996 the basic pension for a single 65 year old man stood at £61.15 per week compared with an Income Support level of £67.05. For older pensioners the gap is bigger. Since 1980 indexation has been in line with prices in each year instead of wages. Thus, the pension level, by the mid 1990s, was about 16% of mean male earnings, compared with 20% in the late 1970s.

Even prior to the introduction of state provision a limited number of occupations – starting with parts of the civil service – were covered by occupational provision. By the late 1930s 1.6 million private sector and 1 million public sector employees were enrolled in such schemes. By the late 1960s around half of all workers were covered by occupational pensions. This proportion has remained relatively steady over the three decades since then. Most occupational pensions are of a defined benefit type where benefit depends on a fraction of final salary. Occupational pensions make up about a quarter of the total income of current pensioners.

The evident and growing disparity between individuals with and without occupational pensions led, after years of dispute, to the introduction of a state second tier pension scheme – The State Earnings Related Pension Scheme (SERPS), in 1978. The SERPS benefit depends on the worker's own earnings. It was intended to provide future pensioners with a pension equal to a quarter of their wages in their best 20 years of earnings (between an upper and a lower limit), in addition to the basic benefit. However, these benefit targets were cut shortly after they were introduced.

An important aspect of SERPS was that occupational plans could *contract out* of it. In return for giving up future rights to SERPS employers and employees could pay lower National Insurance Contributions than those not contracted out. The occupational scheme had to provide at least a *guaranteed minimum pension* equal to the level of SERPS in order to qualify. In effect SERPS was designed to provide earnings-related pensions for workers who were not in an occupational scheme.

There is also now opportunity for people to contract out of SERPS into group or personal defined contribution pensions. Among qualifying workers (earning above the Lower Earnings Limit for National Insurance Contributions) about a half are members of occupational schemes, 28% are members of Personal Pensions and the remaining fifth are in SERPS[1].

The reforms

We have described in brief terms what the pension system in the UK looks like. We now go on to consider in greater detail the major parts of the reform strategy since the early 1980s. The reforms can be divided into four main groups:

1. Price indexation of the basic state pension. This followed a period of 30 years of indexation which, whether on an ad hoc basis or as a result of formal legislation, effectively resulted in the basic pension rising in line with earnings (de facto wage indexation). The shift to price indexation steadily reduced costs relative to wage indexation by reducing the share of average earnings that is replaced by the basic pension.
2. Cutting back on the generosity of SERPS. Moving away from the 20 best years rule, changing the target benefit from 25% to 20% of revalued earnings and halving its generosity to widows effectively halved the future generosity and costs of the benefit. It also significantly reduced its redistributiveness towards women.
3. The introduction of a great deal more personal choice, both through the introduction of Personal Pensions as an option for contracting out of SERPS, and legislation making membership in occupational pensions voluntary. Prior to 1988 employers could make membership mandatory for all or part of their workforce.
4. Equalisation of state pension ages between men and women. This has not occurred, but has been announced. There will be gradual equalisation between the years 2010 and 2020 with the women's pension age rising by six months in each year until it reaches 65 in 2020.

Each of these policies has played a major part in the reform of the UK pension system. Indeed, by accident or by design, the reforms complement one another very well. With a "nugatory" – to use the expression of British Cabinet Minister Michael Portillo – basic pension and a reduced SERPS it was important to make available other pension instruments. Only about half the workforce had access to occupational schemes – part of the reason for introducing SERPS in the first place. Therefore Personal Pensions became necessary. Providing the right not to join an occupational scheme was consistent with the introduction of much more personal, rather than collective, choice and responsibility.

So before going on to consider the effects of each of the sets of reforms in any more detail we should look in a little more depth at why the reforms were carried out at all. One can understand the strategy by reference to just two over-riding objectives – cost containment and encouragement of personal choice and private sector provision.

3. Cost containment

Degree of cost containment. In the short, medium and long term by far the greatest contribution to cost containment comes from the continued price indexation of the basic state pension. Had it been uprated in line with earnings since 1980, spending on it in 1995-96 would have been nearly £36 billion (12% of total government spending) instead of £27 billion. That this increased spending would have been of limited value to the poorest pensioners is illustrated by the fact that nearly £2 billion would have been saved in payments of means-tested benefits.

Even cost savings of this magnitude pale into insignificance when placed against savings in the future. Starting from 1995 the Government Actuary estimates that, in constant pounds, spending on the basic pension will reach £47 billion in 2030 and will remain about constant thereafter. With earnings indexation from 1995, spending would rise to £80 billion in 2030 and £107 billion by 2050. With price indexation National Insurance Contribution rates would need to be barely changed by 2030, but with earnings indexation they might have to rise by nearly ten percentage points. Of course the most serious potential problem with this type of solution to cost containment relates to the drastically falling living standards of pensioners relative to non-pensioners in the future.

Cost containment – for the future – was also one of the driving forces behind the reforms to SERPS set out in the 1986 Social Security Act. The Government Actuary estimated that the reforms to SERPS would cut future spending such that by 2033 the National Insurance Contribution rate could be three percentage points lower than it would otherwise have been.

From a political point of view it is interesting to note that the savings from changes to SERPS *all* lie in the future. The rights of individuals retiring before the year 2000 have not been affected. Because the whole scheme is of recent origin costs up to 2000 were never, in any case, going to be large, reaching just over £4 billion in 2000. So older workers had no reason to oppose the reforms. Following the reforms of 1986 and further more modest reforms introduced in the 1995 Pensions Bill the cost of SERPS will peak at around £12 billion in 2030. The cost in 2030 under the original regime would have been in excess of £40 billion. It is clear from table 1, below, that the large savings from the reforms do not really build up until 2020 or 2030, but they are very significant by then.

Table 1

Financial effects of reforms to SERPS (£billion, 1994/95 prices)

	1994/95	2000/01	2010/11	2020/21	2030/31
Original regime	1.8	4.2	12.0	25.0	41.0
After 1986 Social Security Act	1.8	4.2	9.2	14.5	18.7
After 1995 pensions Act	1.8	4.2	8.4	10.9	12.0

The 1995 reforms were on a smaller scale than those of 1986, but again had as their main effect cost reduction in the future. The biggest was a phased equalisation of state pension ages at 65 for men and women, gradually raising the pension age for women from 60 by 6 months in each year between 2010 and 2020. Also very important was the elimination of a government promise to pay for inflation indexation of part of the occupational pension, in case inflation should exceed 5%. The government withdrew from insuring that risk, which is now borne by workers, pensioners and employers directly involved.

The success and costs of cost containment. On the face of it the massive transfer of responsibility and costs onto the private sector has been very successful. The UK stands almost alone among OECD countries in having no serious increase in future tax burdens predicted as a result of an ageing population. To some extent this reflects a rather less dramatic ageing profile than that seen in most countries. But the most important aspect has been the determined way in which the government has bitten the bullet in recognizing possible future problems early on and tackling them in a radical and effective manner. While other European countries – France, Italy and Germany for example – have only begun to tackle a much bigger problem in the 1990s, the UK government started to pre-empt the potential problems from 1980 onwards. In political terms this is all the more remarkable given that the biggest benefits in the share of lower taxes will not be seen for decades – well beyond the normal political horizon.

Table 2 gives some impression of how the demographic and cost scenarios for the UK differ from those in the rest of Europe. The table is drawn from 1988 OECD figures and is therefore not wholly up to date. It does not incorporate the effects of changes announced to European pension systems in the early 1990s nor to the UK system in the 1995 Pensions Act. Nevertheless the differences between the UK and the rest of Europe are stark. As a proportion of national income UK pension spending is forecast to be half that in the EU as a whole by about 2030. We can see that some of this can be put down to a more favourable demographic scenario, but that accounts for just a fraction of the difference.

Why the UK government has done this, and why it has been able to do so, are interesting points for debate. The answer to the second question – why it has been possible to introduce such far reaching legislation – is the easier to answer. One part of the answer lies in the fact that the implicit pension debt in the UK was relatively small, since SERPS had just started in 1978. With few pensioners receiving SERPS it was not difficult to divert part of the contribution to private pensions. A second part of the answer lies in the power of central government in the UK. With a majority in parliament the executive is virtually unfettered in the policies that it can follow. While this has potential dangers it does mean that when radical legislation which has negative impact on powerful lobby groups is needed, it can nevertheless be forced through with relative ease. There is no separation of powers equivalent to those between, say, Congress, Senate and President in the US. Nor is there a need to deal with fragile party coalitions, as say, in Italy.

This is not to say that the legislative changes have been uncontroversial. Certainly until 1992 the opposition Labour party was committed to reversing most of them. Indeed the original intention of the conservative government prior to the 1986 Act, and set out in the 1985 Green Paper, had been to abolish

SERPS altogether. Considerable lobbying and public disquiet, as well as disagreement within Cabinet (Lawson) saw to it that this did not happen. The reforms as enacted were, though, quite radical enough.

Table 2

Projected old age dependency ratios and public pension expenditure ratios

	1980/84	1990	2000	2010	2020	2030	2040	2050
UK dependency ratio	23.2	23.0	22.3	22.3	25.5	31.1	33.1	30.0
EU average	20.2	20.3	22.0	23.9	27.7	33.6	37.5	35.7
UK spending	7.7		7.5	7.6	8.6	10.6	11.2	10.2
EU average	11.3		12.6	13.8	16.0	19.5	22.0	20.9

Dependency ratios measure ratio of population 65+ to population 15-64; public pension expenditure is as a per cent of national income.
First dependency ratio is for 1980; first public spending ratio is for 1984.
EU is EEC countries as at 1988.
Source: OECD 1988a and 1988b.

By now the reforms have come to enjoy quite wide acceptance and there is little prospect of the Labour party undoing any of them; the leadership appears broadly content with the shape of pensions legislation as it stands. Such cross-party agreement is of course important for the health of a policy on something as long term as pension provision.

That it was possible for the government to enact the legislation is not of course sufficient reason for it to have done so. One reason for its actions was just ideological. A right wing government believed that the private sector could do a better job than the state, and that people should take responsibility for their own futures. Another reason was its understanding of the consequences of ageing and a desire not to see tax rates high, even in the future[2]. Also important was an understanding that pensioners are no longer an homogeneously poor group. (Dilnot and Johnson, 1992, Johnson and Stears, 1995) so that increasing levels of spending on a universal basic pension began to appear anachronistic.

As we have seen, as a measure for cost containment, the new indexation procedure for the basic pension has been successful. Spending on pensions is £9 billion less now than it would have been under an earnings indexed base and saving in the future will be much more substantial. The problems it has caused, and will cause, relate to living standards. If we agree that it is not acceptable for pensioners to live on 15% of average earnings (the current level of the basic pension) and certainly will not be acceptable for them to live on 8% of average earnings (the probable level of the pension by 2030) then it is necessary to find a way of getting money to needy pensioners. Already the basic means-tested benefit – Income Support – is worth up to 20% more than the basic pension for some groups. It has actually increased somewhat faster than prices, at least since 1988. 1 ½ million pensioners – mainly older women – depend on IS, and a further 2 million or so receive means-tested help with their housing costs. Thus the current system relies increasingly on means-tested supplementation, especially for those who have not participated in the labour market and therefore do not have an earning-related benefit.

There is considerable unhappiness with the current means-tested system – it is complex and intrusive, and at least a fifth of those entitled do not receive it. A number of independent commissions have suggested schemes to amalgamate it with the universal pension to provide a "Minimum Pension Guarantee" (Borrie Commission on Social Justice) or an "Assured Pension" (Retirement Income Inquiry). With a growing disparity in pensioner incomes and a general commitment to keep public spending under tight control there seems little doubt that means-testing will be the chose route. If the scope of means-testing is to be extended then familiar problems associated with incentives to save and costs of administration will have to be faced.

The problems related to future cost containment measures for SERPS are of a very different sort. While simply cutting future benefits will result in a reduction in future costs, cutting future costs by encouraging people to contract out of the scheme involves current transition costs.

When people contract out of SERPS into an occupational pension scheme they, and their employer, pay lower National Insurance Contibutions (NICs) than they otherwise would. Should this be considered a current cost to government? At first sight the answer appears to be yes. If they had not contracted out they would have been paying higher NICs. But because NI rates are set, broadly speaking, so that money raised is adequate to cover *current* expenditures, it is not clear that without contracting out the government would be raising more money. Instead, those who are *not* contracted out pay higher NI rates than they would have done if contracting out did not occur.

Where the Personal Pension option is concerned, the exact process is slightly different. The individual and his or her employer continue to pay NICs at the full rate but the government then pays an amount equal to the contracted out rebate into the personal pension plan. The government collects the money and then pays it back again, in return for lower future pension commitments. In addition, between 1988 and 1992, the government offered an additional 2% “incentive” rebate to people taking out PPs. Both for the occupational and the personal plans, an unfunded future commitment is replaced by a current contribution to a fund.

For now let us think of the total rebate as a cost to government. If the rebates were made on an actuarially fair basis then the total level of rebate given should equal the present value of future savings in pension payments. In that case future savings are bought at the expense of current costs, and overall there is neither loss nor gain to the government. But what if the rebates offered are better than actuarially fair? In that case more would be spent in the present than would be saved in the future, and there would be a net present value cost.

Rebates for Personal Pensions were not set to be actuarially fair for individuals. Instead, they provided a substantial incentive for younger individuals to contract out of SERPS. For one thing, by putting contributions in early people could gain from interest compounded over many years. For another, younger generations were slated to receive lower SERPS benefits than did middle-aged generations, because of the gradual way in which cuts were implemented. The government initially offered the same level of rebate independent of age. Not surprisingly, individuals taking up Personal Pensions were overwhelmingly young initially. Over 40% of men in their 20s and early 30s took out a Personal Pension by the early 1990s. As Disney and Whitehouse (1992) show, such individuals might reasonably expect to receive a pension twice what they would from SERPS, just on the basis of the rebates put into their fund by the government. According to National Audit Office (1990) figures, between 1988 and 1993 the gross cost to government of NI rebates and incentives for Personal Pension was £9.3 billion but the present value of savings in future pension payments was just £3.4 billion. This would mean a net present value cost of £5.9 billion (in 1988 prices).

What sense can we make of figures like this? As we have already hinted, the NI system works, roughly speaking, in such a way that enough NI (and tax) is raised to meet current spending. In that case the result is really one about redistribution. Those who have not contracted out of SERPS are paying higher taxes than otherwise to allow those contracting out to end up with a higher pension. This means a redistribution from poorer groups, who tend to remain in SERPS, towards younger affluent Personal Pension optants. It should be noted that this transfer has recently been reduced by the introduction of age-related rebates that are much smaller for young than for older opt-outs.

On top of costs directly associated with contracting out we should also consider the *tax* costs of relying on private pensions. For both Personal and Occupational Pensions tax treatment is broadly similar. Contributions (subject to a relatively high limit) are tax deductible; returns to the fund are tax free; the pension benefit in payment is taxable, but it is possible to take a substantial tax free lump sum.

The tax free lump sum apart, this is effectively an expenditure tax regime with the government deferring collection of the tax until after retirement. On this measure the amount of tax deferred is very substantial. The Inland Revenue calculates that the cost of tax relief on employees' and employers' pension contributions amounted to £5.3 billion in 1994/95. On the other hand £4.3 billion as received by way of tax on receipts of occupational pensions. The cost of tax relief on Personal pensions was about £2 billion. At present there are very few PPs in payment and so no current recouping of tax.

In the long term if one takes the expenditure tax as a benchmark[3] then the main cost of tax relief ought to be considered as the tax lost from allowing tax free lump sums to be paid. Figure pertaining to this are no longer published. The cost in 1990 was estimated at £1 billion. By 1998 it is probable that that figure has much more than doubled.

4. Choice for workers

The second major component of the pension reforms was to extend choice of second tier pension coverage. Prior to 1988 most occupational schemes forced eligible employees to be members. Workers not eligible to join occupational schemes (half the working population) had to belong to SERPS. From a virtually even split between SERPS and Ops the UK now has around half of workers still in Ops, 28% in PPs and only 20% in SERPS.

Tables 3 and 4 show the breakdown of pension coverage in 1992/93 by age, sex and earnings level. The figures are only approximate and have been calculated using micro level data from two years of Family Expenditure Survey with the superimposition of information from administrative statistics on Personal Pension take-up. It was also necessary to impute membership of non-contributory occupational schemes from details of NI contributions. The tables include some people making contributions to Personal Pensions who are not contracted out of SERPS, which explains the relatively large number of PP holders in older groups. Nevertheless the table still underestimates the numbers with PPs.

Two things are immediately apparent – other than the small number of high earning women. The first is that occupational pension coverage increases with age and income. The second is that women, and especially low income women, are much less likely to have private coverage than are men. Overall in these age ranges (excluding the youngest and oldest workers) over 87% of men have some sort of private provision as against just 69% of women. Among those earning more than £10,000 per year, for men and women together, private coverage exceeds 90 per cent. Over 70% of those remaining in SERPS are in the bottom third of the income distribution, earning less than £10,000.

One of the strongest conclusion we can draw from the UK experience of private second pillar pensions is that, given the option, low income people, and especially low income women, are relatively likely to remain with the state scheme.

Table 3

Pension position of men aged 21-60 (over LEL)

Earnings	LEL - £10,000			£10,000 – 20,000			> £20,000			
Age	SERPS	PP	OP	SERPS	PP	OP	SERPS	PP	OP	ALL
21 – 30	250	450	200	200	500	700	50	50	250	2,650
31 – 40	50	250	100	50	500	900	100	150	750	2,800
41 – 50	50	100	50	100	300	800	50	100	850	2,500
51 – 60	150	50	100	150	100	550	50	50	400	1,600
All 21 – 60	500	850	500	500	1,400	2,950	250	350	2,250	9,550

Note: Numbers in thousands. PPs include not contracted out PPs where contributor is not a member of an OP. LEL = Lower Earning Limit, on which taxes are levied.

Table 4

Pension position of women aged 21-60 (over LEL)

Earnings	LEL - £10,000			£10,000 – 20,000			> £20,000			
Age	SERPS	PP	OP	SERPS	PP	OP	SERPS	PP	OP	ALL
21 – 30	300	500	350	50	250	500	-	50	50	2,100
31 – 40	500	250	300	50	150	450	-	-	200	2,000
41 – 50	650	200	450	100	100	450	-	-	200	2,150
51 – 60	400	50	300	50	-	250	-	-	50	1,150
All 21 – 60	1,950	1,000	1,400	250	500	1,650	-	50	500	7,400

Note: same as table 3

As we have seen, the structure for opting into Personal Pensions favours the young, and overwhelmingly it is the young who have taken up the Personal Pension option; evidence that people are generally responding “correctly” to economic incentives. However, a great deal of disquiet has been expressed that, given free choice, many people have made the wrong choice. For most of those moving from SERPS to PPs these misgivings appear to have been misplaced. Both Disney and Whitehouse (1992) and the Securities and Investment Board (1994) show that more than 90 per cent of opt-outs from SERPS will probably be at least as well off with a PP. The real problem of ill-informed choices leading to undesirable outcomes seems to have been among members of occupational schemes leaving their schemes in order to join Personal Pensions. In doing so they have lost their employer’s contributions to the scheme and only in rather special circumstances will this sacrifice be worthwhile. Yet, insurance company salesmen persuaded them to switch.

Table 5, drawn from Disney and Stears (1996), is based on data from the UK General Household Survey and shows the proportion of full-time men, full-time women and part-time women, whose employer runs an occupational scheme, who are *not* members of the scheme. Reasons for non-membership are not given in the data and might be because of exclusion from the scheme as well as because of a choice not to belong. The fall in the proportion of part-time women not covered reflects the effect of European court judgements and the European Community’s directive requiring equal treatment in occupational pension plans. For other groups the increase in the rates of non-membership are quite substantial.

The extent to which this decline in membership has been caused by mis-selling of personal pensions is unclear. The pensions industry is currently in the aftermath of a wide ranging investigation into cases of mis-selling of Personal Pensions, with compensation being offered to those individuals who can show that they received misleading advice and lost money as a result, the numbers involved could be anywhere between 300,000 and a million individuals.

These cases of mis-selling have rather muddied the pensions debate. Many people see all Personal Pensions and voluntary membership of occupational schemes as being tarred with the same brush. Clearly a large number of people, especially older workers, were scandalously misled about the attractiveness of personal pensions relative to their employer's scheme. On the other hand, for the young and mobile, the large tax incentives available to take out Personal Pensions and the penalties effectively imposed on early leavers from DB occupational schemes may have made the switch beneficial despite the loss of employer's contributions.

Table 5

Percentage of covered workers who are *not* members of their pension scheme

Year	Full time men	Full time women	Part time women
1983	13	24	74
1987	16	24	74
1988	17	26	73
1989	18	28	71
1990	19	27	68
1991	21	27	65
1992	19	29	63
1993	21	29	64

Source: Disney and Stears, 1996

Thus the lessons from these experiences are mixed. On the whole the "right" people have left SERPS and joined Personal Pensions, but many left their employer's scheme inadvisedly. Should choice be restricted or should the pensions industry be better regulated? The latter seems preferable, but hard to achieve: regulation is easy; effective regulation less so.

5. Choices for employers

So far the issue of choice has concentrated on employees as individuals. The 1986 Act also opened up a new avenue of choice for employers. Prior to the Act only Defined Benefit occupational schemes could contract out of SERPS. Since the reforms it has also been possible for employer organized schemes offering Defined Contribution arrangements to contract out.

There seems to be little shift of existing schemes from a DB to a DC formula, but two trends are clear. First, virtually all *new* company schemes are of the DC variety. Even by 1991 nearly half a million workers were in new contracted out DC schemes, representing 8% of all members of contracted out employer schemes. A similar number are members of *contracted in* DC schemes. Second, DC plans have been of particular interest in parts of the economy with large numbers of part time or temporary workers for whom a traditional final salary scheme would make little sense (eg in the retail sector) or where the workforce is typically young and mobile (eg in the media).

The shift has not yet reached the proportions seen in the USA where the DB proportion of workers in occupational schemes has fallen from 78% in 1975 to 64% in 1989, and is projected to fall to 64% in 2000 (Turner, 1993; see also Gustman and Steinmeier, 1992). But the UK is moving in that direction. A recent survey conducted for the Confederation of British Industry (CBI, 1994) asked over 500 senior executives, whose schemes covered over one third of private sector membership, what type of pension plan they had, what type, with hindsight, they would have preferred to operate, and what type of plan they predicted they would operate by the year 2010. The results are striking. While 81% operated some form of final salary DB plan, almost no DB schemes had been introduced since 1988. If able to start from scratch only 26% would now choose a DB plan, while 57% would choose to operate on some form of DC basis and 13% would just let their employees buy a personal pension. Looking ahead, only 31% expected to have a pure DB plan by 2010, with the majority expecting to offer some form of DC plan or a hybrid DB-DC plan (such as a base defined benefit supplemented by a target benefit DC arrangement)[4].

6. Conclusions

The reforms of the UK pension system since 1980 have been far reaching indeed. While the UK has always had a big private funded pensions sector the withdrawal of the state over this period has been without parallel in the last century of social security provision. Far-reaching decisions have been made that will reduce costs in the future, have already reduced the basic pensions of current pensioners compared with what they might otherwise have been, and have reduced the state earnings related pension to a residual scheme for the poor. Choices for both employees and employers have been introduced on an unprecedented scale.

The UK no longer has a problem of funding future pension commitments. It has two other problems. The first is one of pensioner poverty. If an adequate universal state pension is not to be provided then something will have to be put in its place. That something is likely to involve some form of means-testing and the government still has to come to grips with the problems that might be involved. The second problem concerns the way in which people make choices about their pension arrangements, and more specifically the way parts of the financial services industry, using “hard sell” techniques, misled very large numbers of people into leaving their company scheme and so losing their company’s contributions.

These problems, and the up front costs inevitably associated with getting people out of unfunded and into funded pensions, should not lead one to view the transition that has occurred in the UK in a negative light. The UK has avoided a huge future fiscal burden that could raise tax rates dramatically. Funded schemes have replaced a PAYG scheme, with possible positive effects on the economy. The advent of Personal Pensions has provided a new pensions savings instrument for millions of previously uncovered people; if we believe people have the right to make choices then we probably have to accept that they will sometimes make the wrong choices. With an adequate social safety net they can be protected from the worst of them. But it is important not to lose sight of the importance of providing that safety net.

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Notes

1. For a description of the historical development of pensions in the UK see, for example, Brown (1990), Creedy and Disney (1984). For outlines of the current system see Dilnot et al. (1994) and Johnson et al. (1996).
2. See, for example, the original work of Hemming and Kay (1982) for a discussion of future costs of SERPS.
3. See Dilnot and Johnson (1992, 1993) for a detailed discussion of these issues.
4. See Disney (1995) for further details.