

Exploding the Myths

**The truth behind
the state pension debate**

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What this pamphlet is all about

Two out of three pensioners make ends meet on incomes below the official poverty line. One in four pensioners have to claim means-tested benefits and this figure is set to grow. Those aged 80 and over, particularly older women and ethnic elders, are among the very poorest in our society.

Something must be done!

The government insist that we cannot afford to increase the provision of the state National Insurance pension system which they control, and as the latest Green Paper¹ on pensions shows, prefers to concentrate their efforts on propping up the private insurance sector in spite of increasing evidence of its unreliability.

Arguments supporting this policy are illogical and riddled with inconsistencies. Yet they are repeated so often by government and the media that they have become a mythology that has clouded the pension debate. This mythology is based upon the mistaken assumptions that occupational pensions and the financial market are secure and open to all of us; that those who cannot afford to pay the necessary premiums will be content with means-tested income support and that the nation will rest with an easy conscience if it abdicates its collective responsibility towards the older generation.

These myths must not be allowed to confuse those who campaign to abolish pensioner poverty.

¹ *Simplicity, security and choice: Working and saving for retirement*, Cm 5677, Dec. 2002

Myth 1: *The state pension is a bedrock that prevents poverty in retirement*

It's official! The government tells us not to depend upon the state pension in our old age - if we are unable to save, we must expect to live out our retirement on the dole or end up collecting shopping trolleys in supermarket car parks, well into our 80s and 90s.

To give them their due, our well-paid politicians are very sorry about this. After all, they say: "What can we do? We want to eliminate pensioner poverty - but we just can't afford to do so."

The state basic retirement pension established in 1908 and reformed by Beveridge in 1948, contrary to common belief, does not eliminate poverty in old age. How shameful that after a lifetime of work and service, millions of older people are asked to accept that, because their pension is so low, they will be officially classified as 'poor' and will have to submit to means-testing in order to obtain income support.

The state pension, based upon social insurance was intended to avoid this. It can no longer achieve its objective, and instead of rectifying this, the government – regardless of the concurrent increase of the pensioner population – plans to cut the proportion of the GDP spent on the basic state pension².

As a result, millions of working people are expected to return to Victorian times when the only provision against destitution was means-tested Poor Relief.

² *Simplicity, security and choice: Working and saving for retirement*, Cm 5677, Dec. 2002

The accepted definition of poverty is having to make ends meet on less than 60% of median income. Today average earnings are around £520 per week. Therefore a weekly income of less than £260 is below the poverty line.

From April 2003, the state basic retirement pension for a single pensioner with a full record of National Insurance contributions is £77.45 a week. At less than 15% of average earnings, it is insufficient to pay for the most basic food and shelter. Those for whom the pension is their main support must therefore rely upon means-tested benefits to survive. Women, who have relied upon being covered by their partner's contribution, receive substantially smaller basic pensions. They make up the majority of the 2.4m pensioners who have to resort to this support.

The common form of income support for the over 60s is the much vaunted Minimum Income Guarantee (MIG). This is a means-tested benefit and should not be confused with the state pension. The MIG only brings the claimant's income up from 15% to 20% of average earnings. At £102.10 a week for an individual and £155.80 for a couple, it still falls short of providing the most basic provision and has to be further supplemented with Housing Benefit and other relief.

The basic state pension continues to fall behind average earnings³, and unless the price and inflation index used to annually review pensions is changed to being linked to average wages, 57% of all pensioners will rely upon such benefits by October 2003⁴.

³ See Table 1

⁴ Hansard 25 June 2001

The impression given by the Department for Work and Pensions that the basic pension is the bedrock upon which a decent retirement is built, is fantasy.

Myth 2: *'Means-testing can eliminate pensioner poverty'*

The government makes a great deal out of the claim that means-testing pensioners is the most effective way of getting financial help to those who need it most. Ministers confidently declare that no pensioner from April 2003 has to live on less than the MIG of £102.10 a week.

Moreover, despite a £10m advertising campaign, 700,000 pensioners who are eligible to receive the MIG – still do not claim it because they are deterred by the complicated, demeaning and intrusive nature of means-testing. These older people are the ones that have fallen through the welfare net and often find themselves surviving on considerably less than even the full state pension level.

The new, much trumpeted, Pension Credit – to be introduced in October 2003 – will reward around 5.5m pensioners (half the pensioner population) for having accrued modest savings during their working lives. It will be means-tested and awarded on a reducing scale – from a few pence for a single pensioner on £134 a week, to a maximum of £13.80 for those with an income up to £100.

It is not available to single pensioners with weekly incomes of more than £135, couples with more than £200 jointly, women aged 60-64 or those with less than a full National Insurance contributions record.

Neither the Pension Credit nor the MIG lifts anyone out of poverty.

Myth 3: *'Higher state pensions do not help the poorest pensioners'*

At first sight, the argument that pension policy has to be influenced by the need to concentrate resources on the poorest pensioners seems plausible. It assumes resources must remain inadequate, and that the philosophy of the means-test justifies the view that the so called better-off pensioners should forego their right to demand a decent pension. This strikes at the heart of National Insurance.

Everyone knows that pensions paid out by occupational and private schemes depend upon the premiums paid. Who would suggest that contributory pensions should relate to the relative needs of the beneficiaries? Yet, precisely this suggestion lies behind government thinking which aims to keep the total expenditure on the state pension as low as possible.

They try to make it appear fair that better-off pensioners should accept less pension income in order to provide for poorer pensioners, rather than accept that the whole nation has the responsibility to provide for poor pensioners. Pensioner poverty will not therefore be eliminated by denying the universal right to an adequate basic pension.

Myth 4: *'We cannot afford to substantially raise the state pension'*

Are our Secretaries of State, Ministers, MPs and the Treasury staff unable to uprate the state pension because, with the best will in the

world, they cannot personally meet the bill? Of course not! Even though they are well-paid and pensioned, nobody expects them to personally stump up the millions required to substantially increase pensions. The 'we' they refer to 'who cannot afford it' must surely be all of us – but we can afford it and all of us will see the benefit from doing so when we retire.

The premise that 'unaffordability' makes it impossible to eliminate pensioner poverty is utterly confounded by the simple fact that we are the world's fourth richest nation. During the last century the growth in our national wealth has increased many times more than the number of those of pensionable age.

During that time we have increased pensions because we do not expect our retired population to survive upon the same basket of groceries, and a few buckets of coal, as did their grandparents.

So how can further improvements in the state pension be achieved?

The state pension is paid through National Insurance and its continuance is determined by parliament. It is secure and a bargain. Administration costs are a mere tenth of most private pension plans and a quarter of what it costs to deliver a means-tested benefit. It is a 'Pay-as-you-go' system. The weekly contributions balance the weekly pensions paid. The funds available depend upon the compulsory contributions from both employees and employers, and these meet the bill of today's pensions.

Increased pensions can be affected through any one, or a combination, of the following measures:

- (i) increasing contribution rates, which are reviewed annually, including raising the Upper Earnings Limit at which contributions are pegged
- (ii) using the growing surplus in the National Insurance fund for an immediate rise, and to ease the impact of raising contributions (at present the fund has a useable surplus of £18.7bn – some 40% of the total annual pay-out)
- (iii) making Treasury grants – this alone would come from general taxation

The ‘can’t afford it’ lobby needs reminding that successive governments have increased the pension beyond that required to keep pace with inflation, principally through increasing contributions. In 1948 the basic single pension was £1.30 per week, today it is £77.45 – an increase of more than twice the rate of inflation.

The nation has found cash to increase pensions in the past, and in our modern, wealthier society, it can do so again. Of course, if pension plans are to pay out higher pensions, higher premiums are required; increasing the state pension means higher National Insurance contributions from employers and employees. However, in return all employees would be guaranteed a higher basic income when they retire - a guarantee backed by government.

Fundamentally, the idea that increasing the basic pension cannot be done, is peddled by those who don’t want to do it. They are set against raising the contributions to the National Insurance fund, because doing so cuts across their rigid determination to control social expenditure at the cost of weakening the welfare state.

Myth 5: ‘Pensioners are already getting a good deal and want something for nothing’

Retirement incomes are by definition unearned. Someone has to pay for them. Workers and employers pay for the state pension through their compulsory contributions to National Insurance. Other income in retirement has to come from the investment of contributions to occupational pension plans or personal pension plans in the financial market or results from personal savings.

Currently 60% of all retirement income is provided by the state, the balance of 40% by the private financial sector.

Since the expenditure of the National Insurance fund, whilst self-financing, is considered as government expenditure, the government declared in 1998 its intention to reverse the state/private proportions⁵.

Reducing the state provision from 60% to 40% and increasing that from the financial market from 40% to 60%, therefore, substantially cuts government expenditure.

The growing number of disastrous company failures and recent stock market developments, make it clear how impossible it is to transfer responsibility for the majority of retirement income to the private sector. Not only have the dividends from occupational and private pension investments fallen, resulting in a diminishing of funds available to meet their obligations, but many companies have gone out of business and their pension plans have collapsed. As increasing numbers of employers terminate defined final salary pension plans in favour of those that offer pensions determined by

⁵ *A new contract for welfare: Partnership in Pensions*, Cm 4179, Dec.1998

the annuity interest rates ruling at the point of retirement⁶, is it any wonder that the working population has lost faith in both current occupational and private pension plans.

This has given rise to the so-called 'pension crisis'. This crisis is that of the private pension sector. The government and the financial sector are desperately seeking ways of encouraging the take-up of the various savings plans on offer, even to the extent of flying the kite of introducing a compulsory element, as a condition of employment.

As a result of this obsessive concentration on attempting to moderate the problems of the private sector, the alternative is largely ignored: state provision through National Insurance. This is not in crisis. It is a long-established, fully-functioning contributory system. All that needs to be done is to raise the level of the state pension, not only in the interests of the working population, but also that of existing pensioners.

Since 1980, when the pension link with earnings was broken, the value of the state pension has continued to decline, so that it is now worth around £30 a week less for a single pensioner than it would have been had the link remained. Free eyesight tests, free TV licences for the over 75s and the winter fuel payment - whilst welcome - do not address the fundamental problem that the pension is too low.

When they were earning, today's pensioners paid for their parents' pensions. They don't want something for nothing. They merely expect the same social contract to apply now it is their time to retire.

⁶ See Appendix

Myth 6: *'Increasing National Insurance places an unfair burden on today's workforce'*

The 'can't afford it' lobby attempts to gain support through advancing the fallacy that increasing National Insurance contributions penalises workers.

It's true that pension increases are normally balanced by employer and employee contributions. The government actuary estimated that in order to raise the pension over the next ten years in line with average earnings, the total of employer and employee contributions would have to increase by an additional 2.7%⁷. What needs to be stressed is that a worker receiving average wage increases would, even after bearing half the extra National Insurance contribution to restore the link, still be better off; and in addition secure a substantially higher state basic pension.

Employees who are hopeful of reaching retirement realise their future quality of life depends upon the pension cover plans they create during their working lives, but the stark reality is that 10m workers currently have no other pension provision than that which will be provided by the state. This therefore is their only route to financial security in their later years.

The trade unions, the TUC, and the majority of the Labour Party rank and file, are united in calling for increasing the state pension as demanded by the National Pensioners Convention. These workers know that increased contributions to National Insurance provide a

⁷ Report of Government Actuary, Fourth Quinquennial Review, 1999

worthwhile assured return – better than they would receive from the same contribution to any private pension plan.

Members of the churches, and the charities Age Concern and Help the Aged are part of this consensus. Their view is supported by the Institute of Public Policy Research, the Pensions Policy Institute and the National Association of Pension Funds.

Although never put to the nation in a referendum, the majority of the population also undoubtedly believes that the state pension should be substantially increased. There is no evidence of a popular movement against increasing the pension even at the cost of higher contributions.

On the contrary, bearing in mind that the basic state pension is less than income support, it is difficult to find anyone against raising the universal basic state pension to at least MIG level, especially in view of the fact that there would be a clawback from the better-off pensioners through income tax.

In spite of this, the government is allowing the basic state pension to drop relative to average earnings, backtracking on its promise to ensure that pensioners share in the nation's rising prosperity.

It is not National Insurance that places an unfair burden on the workforce but the shift towards a profit making private sector.

Myth 7: 'Providing a decent state pension is becoming impossible because the number of pensioners is increasing faster than the number of workers'

Government Ministers and their supporters quote official population statistics and project an alarming scenario. They say that provision of an adequate state pension system is becoming progressively more difficult because the number of pensioners is increasing year by year faster than the number of people of working age. They reveal the fact that the ratio of population of working-age to that of pensioners is dramatically reducing, and that, for the first time there are more people over 60 than children under 16. They assert that as the population of working age falls, the burden of providing for an increasing unwaged older generation is unsustainable. Can the experts be wrong?

In 1908, the year the Old Age Pension was introduced, there were 13.3 workers for every pensioner; in 1961, 5.4 workers, and today only 3.8. But don't panic! This doesn't mean that the national wealth has been reducing. Who would suggest that the nation is poorer today than it was in past generations, or that we are less able to afford hugely better provision for older people than we could a hundred years ago?

Although the greatest reduction in this 'dependency ratio' occurred between 1931 and 1961⁸, during those thirty years, the pension actually increased more than average earnings. During our lifetime the standard of living of both pensioners and the working population has steadily improved. The secret? - increased productivity.

How can the experts fail to appreciate this? Have they never travelled by train and looked out at the passing countryside and noticed how few farm workers there are to be seen in the fields?

⁸ See Table 2

Have they never observed how few people seem to be employed in road and building construction or on the factory shop floor, compared to years ago? More wealth is being produced by fewer workers than ever before. National prosperity has increased not decreased. Health care, education, leisure and cultural facilities are greater now with just over three workers to each dependant pensioner than in 1908 when there were over three times as many⁹.

Our economy can therefore afford progressively better provision for retirement.

Myth 8: 'Working longer is the only way to have a decent income in retirement'

Due to advances in nutrition, hygiene and health care, death rates in infancy and middle age are lower now than they have ever been. More of us live a longer, more active and healthy life than our grandparents. The prospect of living a longer life is perhaps the greatest mark of progress.

Technology has reduced the number of working hours per week necessary to provide food, warmth and shelter. Only fifty years ago a 60-hour week and an annual holiday of just one week were quite common. Now we look forward to having more time to spend with our family and for educational, cultural and leisure pursuits. Furthermore, most of us now hope to enjoy some 30 years of active and healthy retirement.

A number of people have interesting work, and where they have the opportunity of continuing in paid employment beyond state pension

⁹ See Table 3

age, they are very happy to do so. There is no law preventing them from working till the day they die. The age at which an employee retires is left for employers to decide. The self-employed are left to please themselves. It's true that the rules of some occupational pension plans need revising where they prevent an employee picking up their pension as well as their pay. But, unlike the regulations related to the employment of children, there are no legal restrictions on the working age of adults.

Many millions of working people in physically demanding or routine occupations, however, happily retire when they reach the state pension age. If they can make ends meet on their retirement income, they are pleased to take life a bit easier, turning to other more enjoyable or useful, unpaid occupations, in the knowledge that they have earned a decent period of retirement after a lifetime of work.

On no account should it be necessary for someone to work after reaching state pension age because of the need to survive above the poverty level. If that becomes the reason for working in old age, it is not difficult to see that post-pension age work will largely be the lot of the poorest pensioners.

However, the idea that the state pension retirement age should be raised to 67 or 70 is being strongly canvassed. This would result in shortening the retirement of millions of the working population by two or five of their most active and healthy years. But even if the government was able to demonstrate that the nation would benefit from increasing the working population, it's most unlikely to be achieved by putting up the pension age.

If more people go on working beyond retirement age, a gain in numbers at work could only result in creating a similar number of new jobs. Mechanisation is, overall, reducing jobs available in existing enterprises. In 2002, job losses in the region of some three thousand per week have resulted from companies transferring work overseas. Postponing the retirement age does nothing to replace these jobs.

Surely the number employed really depends upon employers' policies, investment and government measures to increase economic activity. Raising the age of retirement contributes little or nothing. The true motivation for increasing the state pension age would be to save money at the cost of placing a new burden on older people, especially the poorest. This is hardly the way to tackle pensioner poverty.

What must be done

The arguments and information contained within this short pamphlet must be used by every pensioner to make the case for a decent basic state pension that is linked to earnings, free from means-testing, and available to all.

Write letters to your MP, lobby them in person and get them to sign any Early Day Motions (eg. EDM 42) that support our campaign, raise the issue with your local councillors, talk to your friends and neighbours, write letters to your local papers and get involved in the work of the National Pensioners Convention (NPC) through one of our many affiliated groups (contact details at the front of this pamphlet).

NPC Policy

- There should be an immediate increase in the basic state pension to the level of the Minimum Income Guarantee (£102.10 single and £155.80 couple from April 2003). In the long term this should be raised further to the level the pension would have been had the link with earnings not been broken in 1980.
- There should be an immediate restoration of the link between the state pension and average earnings to allow pensioners to share in the wealth of the nation they helped to create.
- The government should abandon its plans to abolish SERPS and allow the State Second Pension to remain earnings related.
- The 25p a week age addition at 80 should be increased to £22, in recognition that the oldest pensioners tend to also be the poorest.
- There should be an end to means-testing of pensioners income and a basic state pension paid to all, as of right, with proper credits for those with domestic responsibilities. This should include those married women who were wrongly encouraged to pay reduced contributions.
- There should be no increase in the state pension retirement age of 65 for men and women by 2020.

Tables

Table 1: Weekly single pension from 1908 to 2003

Year	Basic State Pension (£ per week)	Average Earnings (£ per week)	Pension (as % of av. earnings)
1892*	0.25*		
1908	0.25	1.00	25.0%
1948**	1.30**	6.90	18.8%
1958	2.50	12.83	19.5%
1969	5.00	24.85	20.1 %
1978	19.50	83.50	23.4%
1995	58.75	374.60	15.7%
2003	77.45	525.00	14.7%

* **1892 Charles Booth's recommendation**

** **1948 implementation of Beveridge**

Table 2: Pensioner increases and dependency ratio to workers

Period (30 years)	Increase in number of Pensioners	% reduction in ratio of workers to pensioners
1931 to 1961	1.75 times	39%
1961 to 1991	1.34	15%
1991 to 2020*	1.12	3%
2020 to 2050*	1.21	28%

* **Forecast**
Pension age:
1931 to 1991 – Men 65/Women 60
From 2020 – Men 65/Women 65
Working Age: 17 plus

**Table 3: UK Population
Total/Pension Age/Working Age/Ratio (thousands)**

Year	1931 ¹	1961 ¹	1991 ¹	2020 ²	2050 ²
Total	46,038	52,807	57,808	60,312	57,900
Pension Age	4,421	7,747	10,378	11,607	14,009
Working age	28,450	30,323	34,729	36,621	32,734
Ratio of working age to pensioners	6.4	3.9	3.3	3.2	2.3

Source:

¹ Annual Abstracts of Statistics - Central Statistical Office

² National Insurance Fund Long Term Financial Estimates - H160, 31.1.95.

Table 4: Change in the value of the basic state pension as a percentage of GDP per pensioner

Year	1999	2000	2010	2020	2030	2040	2050
If pension uprated by prices	100	99.5	93.0	87.8	75.4	63.6	56.2
If pension uprated by earnings	100	100.8	106.1	112.2	109.1	105.1	104.9

Source: Government Actuary's Quinquennial Review of National Insurance Fund, July 1999

**Table 5: National Insurance Fund
Receipts and Payments Account Year ending 31 March 1999**

<u>Receipts</u>	<u>£ thousands</u>
National Insurance Contributions *	48,831,214
Grant from Class XII	3,300
Compensation for Statutory Sick	558,000
Income from investments	651,362
State Scheme Premiums	102,579
Other Receipts	88,190
Redundancy receipts	<u>20,842</u>
	50,255,487
<u>Payments</u>	
Pension payments	44,438,209
Personal pensions	1,655,709
Administration costs	1,020,966
Redundancy payments	138,031
Transfers to Northern Ireland	315,000
Other payments	<u>18,305</u>
	47,586,220
Excess of receipts over payments	<u>2,669,267</u>
<u>Statement of balances</u>	
Opening balance	9,608,114
Excess of receipts over payments	<u>2,669,267</u>
<u>Closing balance</u>	<u>12,277,381</u>

* Employers 54%; Employees 42%

Source: Department of Social Security, 5 January 2000

Appendix

Principal Pension Schemes in the UK

Basic State Pension

The State Retirement Pension is paid to people who have reached state pension age (currently 60 for women and 65 for men) and have made National Insurance contributions when they were working (or received home responsibility credits). It is often described as a 'Pay-as-you-go' system, in that the contributions received in any year are used to pay out the pensions in that year. From April 2003, employers will contribute 12.8% of the wage bill in National Insurance, whereas employees will pay 11% of their wages between the lower and upper limits (£4615 and £30,940 a year respectively). The level of contributions and the state pension are set every year by government.

State Earnings-Related Pension (SERPS)

The State Earnings-Related Pension (SERPS), introduced by Barbara Castle in 1978, relates to earnings during your working life. It is funded from National Insurance and is based on weekly earnings up to the 60th (women) and 65th (men) birthday. SERPS is 'portable', i.e. it is not tied to a particular employer and when established, guaranteed to continue 100% payment to the surviving spouse of a deceased beneficiary. This has since been changed to only 50%. SERPS is being rundown by the government and for future pensioners has been replaced by the State Second Pension (S2P).

State Second Pension (S2P)

S2P replaces SERPS for all contributions made after April 2002. Like SERPS it is an earnings-related scheme, although the government may move towards a flat-rate pension after 2006. It aims to benefit those earning well below the average, particularly carers, disabled people and low paid workers.

Occupational Schemes

There are two main types of occupational pension schemes.

Defined benefit scheme (DB)

In a DB scheme the level of benefits is determined by the scheme rules. Pensions are generally linked to the length of time an employee is in the scheme and their salary at a set point in time or averaged over a set period. Final salary schemes provide a proportion (such as 1/80th a year of membership of the scheme) of final salary at retirement. Other common variants are based on lifetime average earnings or the best earnings in, say, the last five years of work.

Defined contribution scheme (DC)

A DC scheme, (often called a money purchase scheme), will have set periodic contributions, which are invested. The resulting pension depends on the amount paid into the scheme, the investment return over time, and annuity rates at retirement.

Personal pension schemes

These are defined contribution arrangements between the individual and a pension provider, such as an insurance company. In some cases personal pensions are grouped together – such as a group personal pension. Stakeholder pensions, introduced in April 2001, are specifically aimed at those earnings less than £20,000 a year and have limits set by the government on, among other things, the level of charges.