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Pensioners Penalised for Saving for Retirement

Decline must be reversed by reform where honesty and incentive bring reward, says Frank Field in Politeia pamphlet

No greater challenge faces the governments of many European countries than pension reform. Elsewhere the voters have taken to the streets. But here in the UK, where the story had a different beginning with the successes of occupational and other savings, there has been a dismal twist. Despite that strong foundation of second tier pensions on which reform could have developed, the legacy has been squandered and confidence in pensions' systems has all but collapsed.

In *How Saving Damages Your Retirement*, Frank Field, former Minister for Welfare Reform in the Labour Government, explains such a collapse. Not only has the great post-war success of second tier occupational pensions been 'reined back' as numbers eligible declined and others contracted out. But the widespread increase in means-tested benefits has undermined the system. The many who had worked all their lives, paying taxes and contributing through NICs for their basic state pension, were the losers.

In April 1998, the means-tested Minimum Income Guarantee (MIG) replaced income support. However MIG was set at £70.45, whereas the basic state contributory pension for that year was set at £64.70. This was not, says Field, 'a harmless difference'. 'The state pension for males earned after 44 years of contributions provided an income...of 92 percent of the MIG, which was gained by no effort at all'.

The gap continues to widen and with the latest increase, the state pension's value has fallen to below two thirds of MIG value. But there is more to the story. Because with MIG there is automatic eligibility for council tax relief and free rent the upshot is that 'each MIG recipient has...a net income of around £100 a week over and above the basic state pension'. The position is worse when occupational pension income is taken into account. Once rent and council tax are added 'only a small minority...have...a pension greater than the...income of those [without]...an occupational pension'. In 2001, average income from occupational pensions totalled £68-00 per week.

The message, Field says, is clear: 'Savings now carry a health warning: "prudence could make you financially worse off in retirement"'. This failure of policy is not the only one. The take-up rates for MIG are low as are those for stakeholder pensions and so the welfare strategy 'fails a second vital criterion for success'. Furthermore pension credit will not completely overcome the savings disincentive, while the costs are unsustainable. 'By 2050 the current bill of £2billion will have risen to £26billion in today's prices...equivalent to an 11 pence increase in the standard rate of tax'.

What can be done?

Field explains that the reforms urgently needed to restore confidence in pensions and savings for the future must be based on principles which work. 'The goal must be to establish for the first time in Britain a first-tier pension which is universal and which pays a sum above means-tested assistance level. This requires a payment of around 25 per cent of average earnings'.

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