



Politeia, 22 Charing Cross Road, WC2H 0QP
E mail: info@politeia.co.uk Telephone: 0207 240 5070

PRESS RELEASE

PENSIONS CRISIS SPECIAL

Reverse the Means Testing! Halt Decline in Private Pensions! Restore Incentive to Save! Says Paul Thornton's latest pamphlet

As politicians in the UK – and their electorates – grapple with how to tackle the pensions crisis, they all agree on one fundamental matter: people in the UK to-day are not saving enough. But why is this?

The answer, says Politeia's latest pamphlet, *The Pensions Predicament: Means Testing, the Savings Trap and the Labour Market**, is largely that the decline in savings is due to the policy of means testing. Though traditionally rejected by British Governments of left and right, means testing benefits became more common from the 1960s and was extended (in scope and amount) after 1997 by the Labour Government. In particular, the means tested Minimum Income Guarantee (MIG) for older pensioners introduced in 1999 and was replaced by the Pension Credit which in 2003.

The upshot is that people who receive these more generous means-tested benefits have less incentive to save. And for others, now brought into the scope of means-tested support, there is a second negative effect: the benefit withdrawal rate which they face for the first time - where benefits are withdrawn as private savings increase. The numbers here have soared and the authors draw on recent research which shows that millions more than in 1997 are now so penalised. At the same time the numbers on means-tested benefit has soared from under 2 million in the early 1990s to an estimate of almost 3 million by 2005. Indeed the latest evidence suggests that already 52 per cent of all pensioners are in households eligible for means tested pension credit. That figure will rise to 73 per cent by 2025 and 82 per cent by 2050.

Occupational pensions too are suffering, and both income and cover are declining. The authors' company, Watson Wyatt, found in its 2004 survey that under half of large employers had final salary pension plans that were open to new entrants, by contrast with the 2000 figure of nearly two thirds. At the same time the total contributions to defined contribution schemes averaged at 9.9 per cent - less than half the level of defined benefit schemes. As these pensioners become poorer, the numbers on means tested benefit grow.

And the rising costs to the taxpayer are already a matter of concern. The Government's own figures estimate that, if the percentage of those on means tested Pension Credit rises from 50 per cent to 65 per cent by 2050, this would cost 1 per cent of GDP by 2050, especially as the age dependency ratio is changing.

Where will the money come from? Even if future generations of working people were to be asked to pay, it is unlikely they could do so. The proportion of working taxpayers to the elderly is shrinking. In the UK there will be just about one employee (1.1) to every dependant (children or the elderly) by 2050. And, to make matters worse, the system is extremely complex and confusing, and little understood in the population as a whole.

The authors propose a clear plan based on four proposals to resolve the crisis: *First*, the policy of means testing which leads to more retired people being dependent on means-tested benefits should be reversed. *Second*, to curb rising (and unsustainable) economic costs, the state pension age must be raised. *Third*, the decline in occupational pensions must be reversed. *Fourth*, a transparent system with incentive to save must replace the present over-complicated and confused system.

* **The text will be available by e mail in advance to journalists on application by response to this message.** Enquiries to Paul Thornton on 01737 274583, Jonathan Gardner on 01737 274583, Mike Orszag on 01737 274583 or to Politeia on 0207 240 5070, or by e-mail Paul.Thornton@eu.watsonwyatt.com, Jonathan.Gardner@eu.watsonwyatt.com, Michael.Orszag@eu.watsonwyatt.com, or to info@politeia.co.uk

The authors: Paul Thornton is the Senior Partner of Watson Wyatt LLP; Jonathan Gardner is in the research and development team of Watson Wyatt LLP; Mike Orszag is Head of Research and a partner of Watson Wyatt LLP.