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HEADLINE: In search of a 21st-century solution for pensions: **FRANK FIELD:**

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BODY:

The report last week by the Employer Task Force is the latest serious contribution to a pensions debate that is likely to be the big concern, after Iraq and antisocial behaviour, of the next general election. In part this is simple arithmetic. We know that pensioners' ranks are swelling. Less well appreciated is that the next general election could be the first at which the majority of voters who turn out are pensioners. Equally significant is the very large baby-boomer cohort of 45- to 64-year-olds. Many in this group - whose party allegiances tend to be weaker than those of older voters - will have one eye on retirement and the other watching the main parties' positions closely.

However, numbers are only part of the story. It is the coincidence of three factors - one in the private sector and two concerning state provision - that has propelled pensions up the agenda. The first is the collapse of many companies running underfunded schemes, with scheme members being left stranded. But it is in the state sector, through the inadequacy of the contributory state pensions and the response of ever-greater means-testing, where the government has drawn most fire.

In their first report, the Pensions Commission questioned the state's role from first principles. Should the state aim only to provide a basic minimum or should it ensure that people retire with a pension worth, say, 60 per cent of their pre-retirement income? An important choice has to be made on this part of the commission's analysis.

Of the need to provide a basic minimum there is no disagreement. The government ensures this through a combination of accrued state pension rights and means-tested benefits. But Malcolm Wicks, the pensions minister, had a point when he remarked that the consensus about how to move beyond this lasts for about a paragraph.

Beyond that comes the question of how to finance an improved basic pension. And the answers to this mark a divide in what reformers see as the role of trust in pensions provision. If we agree that the basic minimum should not be means-tested, should it be funded or pay-as-you-go? Should we invest in a stock of real assets to provide income for future pensioners or should we depend on taxing workers in the future? Those in the pure pay-as-you-go camp - such as the National Association of Pension Funds - can point out that because the state pension is pay-as-you-go, it is relatively simple to increase everyone's rights and the objective is achieved.

A switch to full funding has been dismissed because of the "double payment" problem. For example, if a worker had to finance today's unfunded pensions and contribute to his or her own purely funded pension, they would pay twice.

The Pensions Commission argues that funding generates better returns on average than pay-as-you-go (where the implicit rate of return is the growth rate in the economy). But the argument can be taken further. Consider the benefits of a basic pension financed in part by funding and in part by pay-as-you-go - spreading risk between the labour and capital markets. Over the past five years UK gross domestic product growth has been fuelled by record levels of employment leading to record national insurance receipts. By contrast, returns on long-term assets, property excepted, have been historically low.

But go back to the mid to late 1990s and while employment levels were improving the stock market was soaring. Empirical data shows that the performance of different asset classes and the labour market has often been divergent. Spreading risk should make us consider introducing an element of funding into the basic pension.

Voters' unwillingness to trust the government with tax increases weighs heavily against the arguments for a big increase in the pay-as-you-go pension.

Survey after survey shows that much of the working population does not trust the state to deliver its pensions promise. The history of pension reform suggests such scepticism is well founded. Part-funding the basic minimum pension offers the government a way to break the cycle of distrust and is the alternative proposed by the Pensions Reform Group. Instead of relying on an IOU from future workers, individuals would see their growing share of the tangible pool of assets managed by the private sector. By bringing together the investment skills of the private sector, with the guarantee of fairness for all that only the state can provide, such a reform would be a 21st-century solution.

Frank Field MP is chairman of the Pensions Reform Group