Can the UK Afford to Pay for Pensions?

50 expert economists give their view

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Author

David Kingman

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Fairness for Future Generations

The Intergenerational Foundation (www.if.org.uk) is an independent, non-party-political charity that researches the rights of younger and future generations in British policy-making.

Whilst increasing longevity is to be welcomed, our changing national demographic and expectations of entitlement are placing increasingly heavy burdens on younger and future generations. The social contract between generations is under immense strain in housing, health, education, employment, taxation, pensions and the environment. Young people who are worse-off appear to be giving more than their fair share to fund a system that benefits the older, wealthier, section of society.

IF questions this status quo; calling instead for sustainable long-term policies that ensure younger and future generations are better protected by policy makers.

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Summary

There is currently widespread anxiety about the UK national debt which, according to the ONS, stood at £1.084 trillion in November 2012.[1] However, the British government also has a substantial additional burden in the form of pension liabilities, both to its former employees through the various public-sector pension schemes, and to retired members of the general public through the state pension.

Altogether, the UK's public-sector pension liabilities add an extra £1.2 trillion to the government's financial commitments (three-quarters of which are currently unfunded), while the liability for paying the state pension equates to £3.84 trillion.[2] Therefore, these additional liabilities mean that the financial burden which future generations will have to pay off through their taxes is actually over five times larger than the national debt.

It seems reasonable to ask whether this is feasible, especially in light of Britain's worsening demographic outlook as the population ages.

The Intergenerational Foundation has conducted a survey involving 50 of the UK's leading thinkers on economics to gauge whether they think the UK will be able to maintain the current status quo when it comes to paying off its pension liabilities in the future.

Everyone who agreed to participate in the survey was asked to come up with answers to the following pair of questions about Britain's pension liabilities:

1. According to the ONS, Britain currently has £1.2 trillion worth of public-sector pension liabilities, three-quarters of which are unfunded. What do you think is the likelihood that these will all be paid in full?
2. In Britain the state pension is currently paid regardless of other income and assets. However, in some other countries (including Australia) it is means-tested. Do you think means-testing of the state pension is likely to be introduced before 2040?

The 50 economic experts who provided replies to these questions came from all areas of economic thought – including the private sector, academics and actuaries (economists who specialize in managing pension funds). Their well-considered responses and insights into

[1] ONS, 2012 *Public Sector Finances, November 2012*

[2] ONS, 2012 *A broader picture of the public sector balance sheet: State pension and other pension obligations - An update at April 2012*

these questions provided telling evidence of the challenges which younger Britons will face over the coming years.

Given below is a summary of how they answered each question:

Question 1

- 36 (75%) of the respondents said they thought that the UK's public-sector pension liabilities would not be paid in full.

Question 2

- Almost half (46%) of the respondents said that they thought the basic state pension would have become means-tested by 2040.

The rest of this report is illustrated with selected quotes given in response to each question.

IF has respected the wish of some participants that their quotes should only be used anonymously. IF also extends its thanks to the small minority of the participants who submitted their responses without giving a name.

Participation in this survey was entirely voluntary, and those who participated received no reward for taking part. The views expressed by the participants were purely their own, and may not represent those of the organisations that employ them, or the Intergenerational Foundation itself.

Who responded to this survey?

IF would like to thank the following for agreeing to participate in this research:

Carl Emmerson	Deputy Director, Institute for Fiscal Studies
Jim O'Neill	Chairman, Goldman Sachs Asset Management
Lord Layard	Emeritus Professor of Economics, LSE
George Buckley	Chief UK Economist, Deutsche Bank
George Magnus	Author of *The Age of Ageing: How Demographics are Changing the Global Economy and our World*
David Smith	Founder, Beacon Economic Forecasting
Dan Atkinson	Co-author of *Going South: Why Britain will have a Third World Economy by 2014*
Peter Warburton	Chief Economist, Economic Perspectives
Peter Spencer	Chief Economic Advisor, ITEM club
Philip Rush	UK Economist, Nomura
Sarah Hewin	Head of Regional Research, Europe, Standard Chartered Bank
Andrew Lilico	Director and Principle, Europe Economics
Nick Carn	Founder, Carn Macro Advisors
Anastasia Nesvetailova	Reader in International Politics, City University, London
Andrew Mearman	Associate Professor in Economics, Bristol Business School
Lord Turnbull	House of Lords
Andrew Tylecote	Professor of the Economics and Management of Technological Change, University of Sheffield
Avner Offer	Chichele Professor of Economic History, All Souls College, Oxford
Baroness Lister of Burtersett	Emeritus Professor of Social Policy, Loughborough University
Charles Goodhart	Director of the Financial Regulation Research Programme, LSE
Christopher Pissarides	Norman Sosnow Chair in Economics, LSE
Dave Byrne	School of Applied Social Sciences, Durham University
David Newbery	Emeritus Professor of Economics, Churchill College, Cambridge
Ian Gough	Professorial Research Fellow, Centre for the Analysis of Social Exclusion, LSE

Jan Toporowski	Professor of Economics and Finance, SOAS
Jan-Emmanuel De Neve	Lecturer in Political Economy and Behavioural Science, UCL
Jonathan Perraton	Senior Lecturer in Economics, University of Sheffield
Peter Sinclair	Emeritus Professor, Department of Economics, University of Birmingham
Robert Gardner	Founder and Co-Chief Executive, Redington
Bobby Riddaway	Senior Investment Consultant, Buck Consultants
Steve Harrison	Dana Spicer Europe
Chetan Ghosh	Chief Investment Officer, Centrica
Huw Evans	Board Member, Institute of Actuaries
Derek Benstead	Senior Consultant, First Acturial
Con Keating	Head of Research, Brighton Rock Group
Pauline Armitage	First Acturial
Steven Catchpole	Senior Client Manager, Cardano
Daryl Boxall	Senior Risk Analyst, AXA
Chris Wagstaff	Visiting Fellow, Cass Business School
Charles Amos	Former CEO, ICI Pension Fund
Martin Coombes	Consulting Actuary, Innovation
Dennis Leech	Professor of Economics, Warwick University
Les Komaromy	Independent pension consultant
Keith Nunn	Employer Nominated Director, The Pensions Trust
Fraser Smart	Managing Director, Europe, Buck Consultants
D. Pearce	DP Pensions
Robert Branagh	Managing Director of Administration, RPMI

Question 1 – Public Sector Pensions

According to the ONS, Britain currently has £1.2 trillion worth of public-sector pension liabilities, three-quarters of which are unfunded. What do you think is the likelihood that these will all be paid in full?

"There is a near zero risk of a UK sovereign debt default – say 5% to 10%. However, it is more likely that there will be a covert default engineered via high inflation, as in the 1970s. Current UK fiscal policy is not sustainable. Taxes are at their feasible limit, and spending commitments cannot be met."

David Smith, Beacon Economic Forecasting

"Slim to none... Measures to raise the pension age, probably through linking to longevity, seem likely. As does efforts to reduce the upscaling of liabilities – e.g. Relinking to CPI and changing defined benefit schemes to career average."

Philip Rush, Nomura

"The likelihood that these liabilities will be paid in full is as close to zero as statistics allow. In fact, the ONS data don't really tell half the story. To illustrate, in order to finance existing-law pension, healthcare and long-term care commitments for the next 50 years, the government would need to have nearly 4.5 times the current value of GDP in the bank, earning interest that's reinvested each year. This is simply to recognise the enormous funding that our demographic transition will require, and that the burden rises every year corrective actions are deferred. The only way the nation can restore some semblance of budgetary stability, and meet (restructured) obligations is via some combination of social programme reforms to limit the rise in costs, tax increases, and higher economic growth, derived from faster growth in productivity."

George Magnus, Author of *The Age of Ageing: How Demographics are Changing the Global Economy and our World*

"0 – effective default through cutting benefits, means testing, higher tax, restricted eligibility etc is certain."

Nick Carn, Carn Macro Advisors

"The next financial crisis will be a pension crisis."

Anon.

"Zero or pretty near that, at current retirement ages (or even currently planned retirement ages) but those can be raised. I'm not sure how rigid the commitments are (esp. on indexation) but certainly expectations will be disappointed, in some way."

Andrew Tylecote, University of Sheffield

"They may be paid in full but with what indexation, inflation and taxation is most unclear, and from what age."

Anon.

"The probability will decline with time. It will not fall much, if at all, for a decade or two, I think. But 'renegotiation' can be disguised by various devices: higher tax rates at least on larger pensions, weakening the link with inflation, and reduction or elimination of the age-related privileges inherent in the income tax thresholds. And by a switch to defined contributions from defined benefits; as well as by capping."

Anon.

"Unlikely, they will be restructured, softly eroded to make it affordable."

Robert Gardner, Redington

"Unlikely. Lower proportions of current 20-year-olds supporting a larger number of pensioners means that unfunded benefits will have to be met through rises in taxes. This will not be tolerated by a generation that has already been disadvantaged by the generation above."

Anon.

"Using a more robust discount rate, these liabilities are far greater than £1.2 trillion. Despite the perceived strength of the covenant, there is a strong possibility that these will not be paid in full someway down the line."

Anon.

Question 2 – State Pensions

In Britain the state pension is currently paid regardless of other income and assets. However, in some other countries (including Australia) it is means-tested. Do you think means-testing of the state pension is likely to be introduced in the UK before 2040?

"The sea-change in demographics since universal benefits were introduced means that some form of means testing is inevitable and long before 2040, I'd wager. Budgetary management will demand it, and individuals are almost certainly going to be asked to take on a bigger share of their own financial provisioning in old-age, to the extent they can afford to do so."

George Magnus, Author of *The Age of Ageing: How Demographics are Changing the Global Economy and our World*

"This would be a highly politically sensitive issue. If it did happen it would need to be rolled in over a period of many years. The OBR's latest report suggests that a combination of increased health spending and pension payments means that government debt is likely to be much higher in 50 years time. The problem is that over such a long time horizon governments typically don't have the political will to deal with it now. I think there is a good chance, though, of a means-tested state pension by 2040."

Anon.

"Good idea but unlikely to happen. The inability of the government to means-test benefits like the winter fuel allowance, free bus passes and TV licences is a reminder of how difficult it is to target this group [pensioners], which is prone to using its right to vote. If these simple steps that can be easily justified on the grounds of fairness cannot be taken, a wholesale change to state pensions seems completely out of reach."

Philip Rush, Nomura

"No. Instead the state pension will have ceased to be paid by later generations and will [have] become funded."

Andrew Lilico, Europe Economics

"Yes. The criterion of age as a qualifier for state pension may disappear altogether. Could move to a 'Citizen's Income' – a basic income guarantee that was paid to all adults, but means-tested."

Peter Warburton, Economic Perspectives

"Yes – as part of a general process of reneging on promises."

Nick Carn, Carn Macro Advisors

"Rightly or wrongly, I think it likely that means-testing will be brought in some time before 2040."

Anon.

"Yes, I expect it will be; and it should be. But there will be a powerful lobby fighting against it."

Anon.

"I have no idea. There is a variety of ways open to governments to redistribute from richer old to poorer old. Means-testing reduces the incentive to save."

Andrew Tylecote, University of Sheffield

"No, but it will be claimed much later and many of the non pension benefits e.g. bus passes, free prescriptions, winter fuel allowances will be whittled away. Also NI [National Insurance] will be charged on earnings post retirement."

Anon.

"Quite possibly and frankly why not?"

Les Komaromy, Independent pension consultant

"Yes. Any possible reduction in social security costs will be necessary by this point in time, especially for the increasing numbers of elderly. The question is more whether this will result in a sufficient reduction with many people's personal retirement savings likely to be inadequate, so reliance on the state to bridge this gap will likely increase."

Anon.

"UK state pensions are taxed at the recipients' top marginal rate, so there is already substantial clawback. Means-testing would make pensions a welfare benefit, not a right, and would destroy the principle of universality. Political reaction would be against pensions [being] means tested."

David Smith, Beacon Economic Forecasting

Appendix 1: Tally of survey responses

Although 50 responses were received in total for this survey, not all the respondents provided an answer for every single question, which is why the number of responses varies. Please note that this was not intended to be a "tick-box" survey – everyone who received a copy of the survey was invited to write a statement expressing their views in answer to each of the questions; which category ("Strong Likelihood", "Weak Likelihood" etc.) each response fell into was then interpreted at the researcher's personal discretion during the data analysis stage of this study.

1. According to the ONS, Britain currently has £1.2 trillion of public-sector pension liabilities, three-quarters of which are unfunded. What do you think is the likelihood that these will all be paid in full?

Total responses: 48	
Strong likelihood: 12	Weak likelihood: 36

2. In Britain the state pension is currently paid regardless of other income and assets. However, in some other countries (including Australia) it is means-tested. Do you think means-testing of the state pension is likely to be introduced before 2040?

Total responses: 50		
Yes: 23	No: 24	Not Sure: 3

The Intergenerational Foundation
19 Half Moon Lane
London SE249JS
Charity no: 1142 230
www.if.org.uk

For further information on the work of the Intergenerational Foundation please contact:

Liz Emerson on 07971 228823 or email liz@if.org.uk