

Time to take pensions seriously

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I presume it is because I'm 51 that so many of my friends and acquaintances have begun to discuss pensions. In many cases this is whimsical. I appear from my knowledge of their affairs (usually voluntarily imparted and rarely professionally) to be better financially prepared than most for such event, and of all I have least desire to retire. Nothing would please me more than to work till I drop.

I accept that makes me unusual — most seem to anticipate retirement with relish, although I often wonder why. What is the prospect for most in their old age when we continue to prepare for it as badly as we do? And when, as The [Times reported](#) recently:

Britain's pensioners have the fourth highest level of poverty in Europe, according to figures published today by the European Commission.

The over 65's in Britain are, on average, worse off than their counterparts in Romania, Poland and France.

The research, which compared relative poverty in the 27 member states, showed nearly one in three UK over-65s were at risk of poverty - the same proportion as in Lithuania (30 per cent). The EU average was 19 per cent.

Why are we doing so badly?

Consider this: whilst absolutely up to date data is hard to secure it seems likely that more than 50% of pension funds are invested in shares. It matters little where — share price indices seem to participate in synchronised movement these days, and many major companies are quoted in both the USA and UK. And in the ten days before writing this blog the FTSE 100 rose by over 10%. Except here is no logic for that.

Unemployment is rising. With that prospects for the economy must decline. House prices are likely to fall further. Government spending is likely to rise still further as benefit payments increase, and its borrowing with it. All are reasons for the FTSE to fall. But it hasn't. Wholly irrationally it has risen.

That is because market fundamentals have nothing to do with how it performs. So, for

example, it did not fall from its 2008 high because of a change in market fundamentals. The fall is only partly due to the recession. The real reason for it was that the market was irrationally over-priced in early 2008 — a point I made at the time — making me one of the few who did.

Its rise now is as irrational. It contradicts all fundamentals as much as the market high did in early 2008.

And yet pension money remains in this casino.

Worse, the government intends that a compulsory pension scheme requiring all employees in the UK should be introduced which will place about 4% of their annual earnings — compulsorily deducted from their pay — in this same privately owned casino. Employers must add 3%. I cannot predict precisely what that will mean in new contributions — but allowing for half of all employees to be covered and labour costs to be 70% of GDP a figure of at least £20 billion a year seems possible.

Stock markets: shrinking targets for investment

The total value of equity markets is hard to estimate because of dual listings, as noted above. Irrational moves, as in the last few days, also heighten this problem, but let's assume a UK value of about £3 trillion, which is a good approximation at present. The new money is tiny in comparison, or so it would seem. But note this: on average the volume of equities in issue in the USA has been falling for some time because of share buy-backs, and before the recent rash of new share issues in the UK to cover losses (which new issues do not of course result in any value added or new investment — they just replace funds irrationally destroyed by exuberant and wholly misguided management) new share issues for the purpose of making investment in new jobs, equipment, research or infrastructure in the UK were almost unknown. In fact as my colleagues and I showed in our 2003 New Economics Foundation report [“People's Pensions”](#), well over 99% of all share transactions in the year prior to its publication were for the purchase of what we called ‘second hand shares’ — that is shares already in issue by companies who received not one cent of the proceeds of the transaction as a result.

As I described it then, and as I'll continue to describe it now, this amounted to a meaningless trade in what amounted to second hand bits of paper securing very limited rights to a future income stream over which the owner had no control whatsoever, and with regard to which they were entirely at the whim of others, and as a result of which no new investment resulted. This is because the market is, I suggest, deliberately starved of new shares to ensure that the price of existing shares must rise over time as new funds flow into the market — as they do day in day out from pensions and other sources.

Saving is not investment

I make the point very loud and very clear. This may be saving. But please do not for one minute confuse it with investment. It bears no relationship to the latter, at all. There is no (none, nil, zero — say it however you wish, it remains the same) connection

between buying shares as a result of paying money into a pension fund and creating new wealth for the future. What that process of buying that share does is two things. First it buys a reducing portion of a finite pot of future wealth — the division of which is now more diluted than it was before, thereby reducing potential future well-being of all participants. Secondly it buys out those now receiving pensions wishing to cash in their chips — which means that this exercise is remarkably like the unfunded state pension scheme as a consequence, with current pensioners being paid by the contributions of future pensioners who actually have no real claim to future entitlement as a result — a fact that is guaranteed by the new trend towards defined contribution not defined benefit pension schemes.

To put it another way — and to avoid all subtlety about this — the current pension contributions of those employees that are used to buy shares are, for all practical purposes, being flushed away forever because they create no added value, bar allowing current pensions to be paid by creating the necessary current liquidity in the market to let the currently old quit the market for good.

The City then takes its cut
Except it's even worse than that, because due to the deliberate opacity in the stock market and pension arrangements of the vast majority of people the opportunity for those who run the casino to take a significant cut out of this process is created. Let me quite clear about what I am saying: I am saying that the whole City infrastructure that exists to support the stock market / broking firm / pension adviser / pension fund structure is a deliberate construct to extract current income for an elite few at the expense of the future well being of UK pensioners. This is the most massive fraud. Just as the money saved by pension funds in shares (note, saved, not invested) creates no added value for the economy, nor do these people. Far from it.

They cannot for three reasons. First you can't create value from administering a system itself designed not to add value: even if you are doing something really worthless well it still does not make it worthwhile.

Second, as evidence of investment performance shows time and again — these people have no more idea about how the market as a whole or parts of it will move than anyone else — precisely because market moves are irrational and therefore wholly unpredictable unless rigged in the short term (as, no doubt, some are- as the evidence of unusual activity before stock exchange announcements shows time and time and time again).

And third, they cannot because those undertaking these trades know that this is the case — for them what they do is the opportunity for jam today by top slicing all the transactions they undertake with charges excessive to any reasonable rate of return, knowing that the impact either cannot be revealed or will not be revealed until so long after they event that they cannot and will not be held accountable for the process of deliberately or knowingly transferring future wealth of others into current consumption for themselves.

I stress: this last process is how the City pays the exorbitant returns it does. These are not earned — they are simply taken from the future benefits of those who entrust funds to investment companies. The fraud (the art of securing financial advantage by deception) is achieved by appearing victimless simply because the future loss and therefore the future victim have yet to be identified. That is all that covers the offence — and offence it is even if, as can be the case with fraud, it is not of the criminal kind. And if in doubt about this — note that the [Daily Telegraph](#) has now reported that the Stock Exchange is now more than a quarter lower than its level at the end of 1999. Even the true believers aren't sure of its merits any more.

Irrational provision for pensions

So we have a system for the provision of future pensions that is based on irrational behaviour, a failure to create value added, which is more akin to a pay-as-you-go scheme for current pensioners than a savings mechanism for new ones, all of which is hidden by an albeit non-criminal fraudulent process of deception which enriches those in the City at cost to all our futures. Why then is anyone looking forward to retirement (bar those, with the good fortune to be in government backed final salary arrangements — now the target of much abuse from the so called free market press — which wishes, it seems, to join in the general myopia about free market pensions)?

A left perspective

I've been discussing what should define the Left of late. [Putting people first](#) is one such thing. A belief in the [value of public services](#) — and the capacity of the state to supply what people need better than any other mechanism could — is another. Providing decent pensions for people in old age must be a third. And given the almost certain increase in the number of pensioners in the UK, it is one of paramount importance, especially as capacity to work does not appear to have increased with life expectancy — which is more related to longer endurance of infirmity — and nor has the willingness of employers to offer that work increased either, even if there were many more willing and able to offer it.

This therefore is no minor issue. It is an area of fundamental importance — and one where I would expect politics to play a key role in defining how the provision is to be made. The right believe in what we have — a market based process, which for all the reason noted is bound to fail, and will do so all the more quickly the more who are forced into it, so exposing its weakness all the more obviously — albeit after a delay of a decade or two — as is the habit with pension reforms. The left (if New Labour can be described as the left) seem guilty of the same crime at present. And that is one very good reason why the left must be reformed for this is the path to disaster.

The alternatives

There are alternatives. I suggest two here. One is a variation on an idea I have mentioned before — and which is in my part my creation — the idea the creation of a brilliant Swede.

Option 1 — use pension money to pay for public infrastructure

As anyone but a fool must now be aware, the City has only survived on the back of government guarantees. But that guarantee banking would have collapsed in October 2008, and pension funds would have fallen alongside them. The simple fact is that

nothing in the financial services sector now operates without an implicit government guarantee. And that is undoubtedly true of pensions as much as anything else.

In that case it makes no sense at all that the vast majority of pension funds are invested in the private sector and that only a small proportion end up invested in government securities. If, as is the case, at least 40% of the economy is within the state sector then logically at least 40% of pension investment needs to be invested in this same sector if it is to have the resources it needs to provide the infrastructure that underpins our whole economy and society: things like schools, hospitals, transport systems, housing, green generation equipment, and more besides.

In 2003 I suggested, along with Colin Hines and Alan Simpson MP, that [People's Pension](#) funds should be created to provide funds to the government, local government, health authorities and other agencies so that long-term infrastructure projects could be provided. People's Pension funds would be a cheaper alternative than the much hated PFI scheme. And we know that these projects can pay a rate of return: the returns paid on PFI schemes are very high, and much better than anything any pensioner would dream of earning on their fund.

I remain convinced that this proposal is still valid: it provides a secure, government guaranteed rate of return which at the same time ensures that people can invest funds into their local communities and so see a current rate of return as well as a long-term one.

And this type of investment has that long-term essential quality that any pension fund should have. After all, a pension fund is meant to create assets by the effort of one generation that they can sell in their retirement to the next generation in exchange for that next generation providing them with the services that they will be when they are no longer able to work. Quite explicitly building public infrastructure does create assets of worth to the next generation which they will be willing to pay for through their taxation payments.

As such this proposal has three essential qualities: it makes economic sense, it has an implicit guarantee which makes it an incredibly attractive investment and it enhances the current options within the economy by finally laying the PFI scheme to rest, by creating a pool of funds for new public infrastructure investment which is essential at this point of time and by creating current and very obvious economic activity that makes the decision to invest in this way for the long-term acceptable to an electorate demanding current satisfaction.

Option 2 — A pension tax

Another option is a pension tax based on the pioneering work of Rudolf Meidner in the 1950s and 60s in Sweden. This would require that all companies employing more than a small number of staff each year to pay a tax settled in the form of an issue of their shares. The rate would need to be determined, but it would be a significant percentage: [BT will be making pension contributions equivalent to 20% of its market capitalisation](#)

over the next 4 years. A tax rate of 5% of capital might therefore be required.

The shares in question would be issued to a national pension fund. That fund would have obligation to manage those investments to make a return to pay pensions for all people in the UK, not just the employees of the companies that are taxed.

The benefits of the tax are obvious: it does not reduce the cash capacity of the companies that make it to invest in the future as do current pension contributions; it cuts out the current 'middle man' in the form of the City that currently extracts an undue percentage from all pension contributions made, and it is applied across the board.

Of course there are problems that would need to be tackled, such as the enforcement of the obligation on the subsidiaries of foreign companies trading in the UK. Cash alternatives might be required if they cannot or do not make equity contributions. These would have to be enforceable. But these are technical issues. The fact is the tax is needed to ensure that sufficient wealth is transferred into funds maintained for the benefit of the retired population of the UK. Nothing else can provide those funds that are needed to prevent mass poverty amongst the old whilst maintaining the active investment required in productive capital needed to generate the real wealth on which they will depend.

Conclusion

Of course we can ignore the pension issue.

And of course we can hope the market will solve it.

But the reality is that pensioners in the UK are poor — and getting poorer and that is a national scandal. and one that the market situation would appear to be making worse.

It is a scandal that we are supposedly solving this by, in effect, forcing ordinary people in this country to pay an annual subsidy to the City of London of 4% of their earnings from 2011 onwards. we know that the City will lose those funds. We know that the only people whose wealth will benefit from this will be those bankers and others who have already brought our economy to the brink of total collapse.

It's time for new thinking on pensions. The options presented here look radical — but make complete economic sense. They keep cash in companies. They prevent excess flows of funds into the stock market which only create economic bubbles. They stimulate new investment and jobs. They reflect the underlying reality of the pension contract between the generations.

If we are to meet the needs of the older people in our country now and in the future we have to be bold. This is a policy that the Left could deliver to fulfil their hope of a good retirement. Isn't it time the Left embraced it?