Why our pension schemes and arrangements do not work

Published: January 13, 2026, 11:06 am

I note there are those griping on this blog and elsewhere that any change in pension rules by the government will make pensions even less affordable than now and undermine the credibility of our pensions arrangements.

Let me be clear: this is wrong. Our current pension arrangements do not and can never work for reasons I explained in 'Making Pensions Work'. In that report I said:

It is our suggestion that this scheme is unaffordable because it ignores the fundamental pension contract that should exist within any society. This is that one generation, the older one, will through its own efforts create capital assets and infrastructure in both the state and private sectors which the following younger generation can use in the course of their work. In exchange for their subsequent use of these assets for their own benefit that succeeding younger generation will, in effect, meet the income needs of the older generation when they are in retirement. Unless this fundamental compact that underpins all pensions is honoured any pension system will fail.

This compact is ignored in the existing pension system that does not even recognise that it exists. Our state subsidised saving for pensions makes no link between that activity and the necessary investment in new capital goods, infrastructure, job creation and skills that we need as a country. As a result state subsidy is being given with no return to the state appearing to arise as a consequence, precisely because this is a subsidy for saving which does not generate any new wealth. This is the fundamental economic problem and malaise in our current pension arrangement.

Tinkering with tax reliefs, and even compelling people to pay into funds that ignore this reality will make no difference to our ability to pay pensions. That capacity is not based on our ability to save (limited as that is). Our ability to pay pensions is based on our capacity to invest - and that has almost disappeared right now. This is why pensions do not work. And that is why in that same report I recommended:

If pension saving is to be encouraged or even enforced then the government has a duty to ensure that the funds so saved are invested for the common good. Pension fund *performance over the last decade has a been a history of almost perpetual loss making despite the enormous subsidies that pension fund tax relief has provided to the City of London and stock markets, all of which they have frittered away. Investment in local authority bonds for local regeneration, or in bonds or shares issued by a new Green Investment Bank and in hypothecated bonds e.g. to provide alternative funding to replace the inefficiently expensive Private Finance Initiative for funding public sector infrastructure projects would have prevented those losses — because all of these would have paid positive returns to pension fund investors. It is for exactly this reason that we recommend that such assets be the basis for any new state pension fund in the future.*

The impact of our proposals would be significant. If 25% of all new pension contributions were to be required to be invested in projects creating new jobs primarily in the UK then at least £20 billion a year would be released into the UK economy for new investment.

People would then understand what their pension funds were doing, and could hold them to account for it.

State subsidies to pension funds would then produce real economic returns for the government.

And the incentive to save in pensions would be real — because people would see the benefits of doing so for their immediate well being, for their own future income and for the benefit of their children.

To date pension funds have been an almost perfect example of what Keynes described as 'the paradox of thrift' — saving that sucked demand and well being out of the economy. We need something very different now. We need pension funds that can build economic will being for the present and the future. The recommendations in this report show that sensible reform of pension funds and the tax subsidies they enjoy could make pension funds the engine for economic regeneration in the UK. No reform is of greater importance than that.

This is the basis for a viable pension arrangement. What we have is not. It's time we acknowledged the fact that we have the economics and mechanisms of pension provision wrong. Then we might effect real change. Right now we continue to give money to the City. And that's the last thing we need to do.