Funding the Future

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There are a lot of people asking me what I would do about pensions today. So here form 2010 is my answer:

*Finance for the Future, a partnership between me and fellow Green New Deal member and environmentalist Colin Hines, has published a new report this weekend. Entitled â€š 'Making Pensions Work' it explores the reasons for the failure of the UK pension industry to supply decent pensions for all when the UK's supposed economic specialism is the supply of financial services.*

*We recognise that the UK has a pension crisis and that lots of supposed explanations and excuses have been offered. The general assumption is that it is state pensions that are the cause of our problems. This report challenges that assumption. It shows that the problem in the UK's pension system is not to be found in the state sector, but within our private pension funds.*

*The findings are shocking. Using data for the most recent year available — 2007/08 — we show that total pensions paid in that year amounted to £117.6 billion. Of this sum £57.6 billion was state old aged pensions, £25 billion was state employment related pensions paid to former civil servants and other former public employees and £35 billion was private sector pension payments.*

***The subsidy to the UK private pension industry is bigger than the pensions they pay***

***In the same year the total cost of subsidies to the private UK pension industry through tax and national insurance reliefs on contributions made and from the tax exemption of income of pension funds amounted to £37.6 billion. The result was that, albeit indirectly, the entire cost of private sector pensions paid in that year was covered by tax reliefs given to the private sector pension funds that paid them. To put it another way, every single penny of the cost of UK pension payments in 2007/08 was in effect paid by the UK government.***

***The annual pension industry subsidy is as big as the defence budget — but no***

*one is questioning it*

*Understanding this quite shocking fact changes two debates. A pension subsidy of about £38 billion represents approximately 25% of the UK government's current annual fiscal deficit, 7% of government income and 5.5% of government spending if repeated in the current financial year. To put it in context, this subsidy for private pensions is almost exactly the same as the current UK defence budget. This makes the subsidy given to our pension industry one of the biggest items of state spending in the UK. And yet, to date, no one has asked if it is justified, or well spent, or should continue. In an environment where cuts are being threatened for almost all state spending this is an extraordinary situation.*

*Subsidies to private pensions over ten years represented almost half of all government borrowing by March 2009*

*It is all the more surprising when it is realised that from 1998/99 to 2008/09 pension subsidies to the UK private pension sector cost the UK government £300 billion. To put this in context, in March 2009 total UK government borrowing was £617 billion. In other words, almost half of all UK government debt at the end of 2008/09 had arisen solely because of subsidies given to private pensions over the previous decade. Understanding this changes the deficit debate and yet it has entirely avoided discussion to date.*

*The direction of pension reform is wrong*

*Simple consideration of these facts leads to the obvious conclusion that the current direction of UK pension reform is wrong. That reform, proposed by Lord Turner and legislated by the last Labour government assumed a world of ongoing economic growth and ever rising stock markets. From 2013 onwards the 56% of people in the UK who currently do not save for a pension will be heavily encouraged to do so through the NEST contributory defined pension scheme that is scheduled to be introduced from that year, with full implementation in 2016. Contributions will amount to 8% of an employees pay — which some have suggested as unaffordable as the state pensions the system is meant to supplement.*

*Understanding the fundamental pension contract*

*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.*

*The reform that is needed*

*In this paper we set out our evidence that demonstrates the inadequacy of the performance of current private pension funds and we show as a result how misguided it would be to base the future well being of the elderly population of this country on this failed model of pension provision. We do, however, go further by offering recommendations for radical reform of our pension system.*

*Pension tax relief must be linked to real investment in real jobs and real technology and real new infrastructure*

*Most importantly we suggest that if those pension funds are to attract tax relief in future they must use a significant part of the £80 billion of contributions they receive each year to invest in new jobs, new technology and new infrastructure for the UK so that the wealth that is needed to grow our economy, to create jobs and to build the real capital base that must be passed to the next generation is built on the back of pension fund investment. As the report shows they do not do this at present. Most of the assets of pension funds are currently invested in short term speculation that has no impact on real growth prospects in our economy, and may actually harm it.*

*Pension funds must be accountable*

*Next we suggest radical improvements in the transparency of pension funds so that all pension investors can hold them to account for the use of the money entrusted to their care — something that is impossible to do at present.*

*Clearing pension deficits and mutualising ownership*

*Thirdly, we recommend that current pension deficits in final salary schemes be cleared wherever possible by the issue of new shares in the companies*

***responsible for those funds. This would stop the current fruitless drainage of cash out of companies that should be used for real investment and which is instead directed via pension funds into the stock market to buy shares in other companies, the only benefit of which is to create a spiral of stock exchange boom and bust. We also suggest that future contributions to such final salary pension schemes might also be paid, at least in part, by issuing new shares in the companies responsible for those final salary pension schemes. This would free cash within those companies for real investment in real products and services that create wealth in the UK economy. The benefit of that investment in new products and services would then be shared with the people working in those companies as a result of the mutualisation of their ownership via their pension funds.***

***Stopping the subsidy to the City of London and investing it in jobs***

***Lastly we recommend that if enforced saving is to be required by the government then that 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 reform***

***The impact of our proposals would be significant. At least £20 billion a year would be released into the UK economy for new investment.***

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

***State subsidies to pension funds would 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 recommendation 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.***

***That is why we want to make pensions work right now, for the future of the elderly in this country and for our children.***

***The report is available here.***

Some numbers would need updating now.

The ideas don't.