Funding the Future

Is your pension safe?

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People assume pensions are “saved money” — a pot with their name on it, safely invested for the future. They aren’t.

In this video, I explain how UK pensions actually work, why defined contribution pensions are inherently risky, and why most pension money fuels speculation rather than real investment.

I look at the state pension, defined benefit schemes, and defined contribution pensions and explain who really benefits from the current system, why it is unjust, and why reform is now unavoidable.

This is not pension advice. It is a political economy explanation of why pension insecurity is being built into the system by design.

https://www.youtube.com/watch?v=GQtGuXfFbT0?si=_mRSVzRygCCy74LI

This is the audio version:

https://www.podbean.com/player-v2/?i=ykbit-1a30ea6-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

In response to a recent video I made in which I discussed the nature of savings, a lot of people ask the question: "Is my pension safe?" And "Can I really depend on it in my old-age?" And I think those are really good questions at this moment because the question is what actually backs a pension? That is the issue I raised in the video in question, and this is a matter for this moment and not for later.

Many people believe that their pensions are 'saved money'. That there is a pot with a real asset somewhere with their name on it, and even that paying National Insurance guarantees that you will have security in your old-age, but none of this is as simple as it sounds.

Let's just stand back for a moment and talk about the three main types of pensions that exist in the UK at present, although there are variations on each, and I cannot possibly cover all the nuances.

The first type of pension is the state old-age pension, and even that comes in two forms.

Then there are defined benefit pensions, and I'll explain what they are in a moment.

And finally, there are defined-contribution pensions, and there are plenty of varieties of those.

Each depends, though, on other people's behaviour for their safety, and that is the critical point that I'm going to make in this video.

You cannot by yourself guarantee that you will ever get pension safety. All you can do is make the best possible choices and hope that others will deliver for you.

Let's talk about that state old-age pension first. This matters to people. I know. I have one. I'm now old enough to claim this pension, and it has existed for over a century; that's a surprise to most people. It was actually created before World War One, by a Liberal government. And the current full rates are £9,175 a year, if you were born before 1951, and rather bizarrely, £11,973 if you were born later. So, if you're older, you get less pension, which to me makes no sense at all. But in either case, the point is clear; this is well below the UK minimum wage. It's going to be very hard to survive by yourself on this income, and the provision for couples is, if anything, less generous still.

So there are real risks in simply thinking that the state old-age pension will provide for you, and there's another risk as well, and that is that you are going to have to rely on the goodwill of politicians if this pension is going to continue to increase. For the last 12 or more years, this pension has increased by the maximum of three things: that has been wage growth in the previous year, inflation in the previous year, or 2.5%. That's called the triple lock, and it has been the subject of a great deal of discussion over the last few years as austerity has really come home to bite.

So far, the triple lock has survived all attempts to cut it. But this inflation protection, which means that the state pension has, in fact, risen by a little more than the rate of inflation, is something where you are relying on government goodwill. That government goodwill could run out at any moment, and then your state old-age pension might not keep up with inflation. So, even this promise to pay is something that you cannot rely on, and just ask women over the age of 60 at present whether they can rely on the government's promises with regard to pensions, and I think you'll hear some very, very loud noises and comments. The government is not a reliable pension provider on all occasions, albeit that for many, it's absolutely critical to the way in which they survive in old-age.

Now, let's talk about private pensions. And again, as I mentioned earlier, there are two types. The first is the defined benefit pension; the type that everyone would like to have, but only a very few people now enjoy. It's a promise to pay you in retirement, a proportion of your final salary from the time when you were in employment, of course, based upon the number of years of service you had. You wouldn't get a full pension for one year of work before you retired. The actual outcome was normally that you got around two-thirds of your final salary, presuming that you'd worked around 35 to 40 years for the employer, and so not many people got a full defined benefit pension, but for those who did, it was a great scheme.

These were once common. They were normal in big business as well as in government, but business, as I will note in a moment, has now retreated from them. They are now almost only found in the state sector: the NHS, teachers, local government, and the civil service, plus the armed forces, all enjoy pensions of this sort. Now, these are generally safe. They're not entirely risk-free, and if you have a defined benefit pension from a private sector employer, that is definitely not risk-free because, of course, the employer could go bust and there might be funds owing to the pension fund at the time that they did so, and that can prejudice future payments as some people have found for their costs, albeit the government has set up a fund to try and help people in that situation. But the point is, this overall is a great pension arrangement, but fewer and fewer people are enjoying it.

So what are they getting instead? Well, because businesses realised how expensive defined benefit pensions were, they basically walked away from them. They've done so in this century. For the last 25 years or so, employers have shifted away from this type of defined benefit pension to a defined contribution pension, and the arrangement is fundamentally different.

You and your employer will be paying into a defined contribution pension scheme. Only you will be paying in if you're self-employed, of course. And that money will be invested on your behalf by a fund manager. There will be no guaranteed return. All the risk lies with you, and this is the fundamental difference between a defined benefit pension scheme and a defined contribution benefit scheme.

In a defined benefit pension scheme, the risk rests with the employer. They've given a guarantee.

In a defined contribution scheme you are dependent upon the vagaries and fortunes of the market to deliver you an outcome you desire. If there's a market crash, just at the moment you are about to retire, your pension could crash with it, and that's what's important. You have no recourse to your employer, or the pension manager, or anyone else. They will claim the decisions made were all by you, even though you will be remarkably uninformed to make them in many cases, because most people are not long-term pension managers.

There is a danger in this, and there's an immediate danger at this moment. We know we are facing an AI bubble. We know that there is a risk of banking instability as a result. We know there's a risk of a financial crisis; we're already seeing the signs of this. Gold is going through the roof in terms of value, and that's always an indicator that a recession might be coming. In this situation, defined contribution pension values could collapse, and the only mitigation is that you move your money to safer assets, but you would have to decide to do that.

But overall, the problem is actually one of what's underneath these pensions, and you need to understand that to make that decision about whether you want to reallocate funds.

What do pensions actually invest in? They buy shares. They buy property. Almost always secondhand property; in other words, not new ones. They buy corporate bonds, and they buy government bonds.

Now, government bonds are usually good value investments, but they can change in value quite considerably depending on the way in which interest rates go, so even they are not guaranteed to give a return inside a defined contribution pension fund.

Shares create no new value in the economy, almost invariably. Why? Because shares are issued either as part of merger and acquisition activity. In other words, one company buying another one, which does not create new value in terms of new jobs, usually it in fact destroys jobs, and it does not fund new investment.

I've already mentioned that the properties that most pension funds buy are already in existence; therefore, new jobs are not created.

And that's also true of corporate bonds. Most of the bonds issued by large companies, the AI sector at the moment is an exception, but most of the bonds issued by large companies are put into issue to pay for corporate takeovers. There is very little investment funded by corporate bonds; some, but not much.

And the point about this is that these investments do not therefore fund real investment. They do not create value in the economy. They don't create jobs. They don't do anything in terms of productive investment.

And new shares are, anyway, incredibly rare now; they usually only represent the original owners of a company bringing their venture to market and then selling out, whilst corporate bonds are usually about mergers.

And even in the case of government bonds, they don't fund anything either. And let's be clear about this. In the way in which the bonds that are issued at present are structured, they have no direct relationship with investment because that is funded by the Bank of England through the creation of new money. That could be changed. Bonds could be used as a pot of capital to fund new investment, but that is not the way things are done at present. In other words, your pension fund is just a financial charade.

Pension funds are just a mechanism for financial speculation, and you are relying on this form of gambling. Let's not pretend it's anything else. You are literally gambling your future by saving in a pension fund.

Values will only rise if more people join. That has been the perpetual story of pension funds. Our population in the UK has grown during my lifetime from something in the 40 million to something in the high 60 million now. That has created a continual stream of new entrants into pension funds. The consequence is, there's always been more money flowing in, the money flowing out. This is a system that has been totally dependent upon that flow.

This, however, is not sustainable. There are two reasons why that is not going to continue. One is the fact that there is going to be a fall in the working-age population. We know that because of a change in demographics, people in general in this country are getting older. The number of young people replacing these older people who are retiring is falling. There's also, and let's be clear about it; anti-immigration policy. That is also going to deny us the people we need to keep our pension system topped up. In purely practical terms, that has a massive consequence; it means that the current values of shares can't be sustained.

On top of this, there are other systemic problems. For example, half of all young people are now heavily taxed, more than the previous generation were, because they effectively pay a 9% extra tax as a student loan surcharge. They will therefore not be able to build up the large pension pots which were common in previous generations. And as a result, money flowing into pension schemes will again fall. What this means is that this model, which is dependent upon ever-increasing contributions, cannot survive.

So, is the pension system safe with regard to the state pension? Possibly. But it is inadequate.

With regard to defined benefit pensions? Probably, with caveats in the private sector.

With regard to defined contribution pensions? Clearly not. Despite the fact that the UK state spends more than £70 billion a year in tax subsidies to the pension industry, we cannot say that the pensions of the majority of people in the UK who are subsidised by that system are actually safe or even worthwhile in the long term, and this is staggering.

This subsidy is also deeply unjust. More of it goes to the wealthy than anyone else, of course. Why? Because they put more into their pensions than anyone else. That's glaringly obvious. In fact, the top few per cent of income earners in the UK might well get a benefit of £10,000 a year from these pension subsidies, way in excess of universal credit, by the way. That is because of the amount of subsidy they get in the way of income tax subsidies, National Insurance subsidies, corporation tax subsidies, and tax savings within the pension fund.

This whole system is indefensible. It's about a benefit system for the wealthy, but it doesn't provide pension security to most people. Instead, it just fuels speculation, and it enriches the City of London. The fact is that these pension subsidies are being used to fund the profits of today's pension funds, but not to guarantee the future of tomorrow's retirees.

So, we need reform, and we need it very badly. If you want a safe pension, we have to change the pension system, and bizarrely, one way to do that is to end excessive tax relief for the wealthy. If we stopped subsidising those who do not need a subsidy to save, we could release more than £20 billion, at least, a year for other uses.

What would I do with that? I would simply reallocate it to the basic state pension. I would guarantee that the floor on which people rely is increased so that everybody has a more secure income in old-age. Dignity requires that. We do not need to spend money the way we are now on a few; we need to spend it on everyone. And this is about collective provision and not market fantasy. That is my second reform, therefore, improve the state pension.

The third reform is quite simple, and it is that we need to make a new connection between pension fund contributions and productive investment. It is absurd that this link has been broken. Economists still think it's there. They still claim that savings fund investment. They don't in the way in which the UK savings system works. There is no link between savings and training, and in education and infrastructure investment, or the creation of new technology, or just about anything else at present in the UK. So, we need to create that, and if 25% of all new pension contributions - just new ones - were allocated to investment in productive activity a year, something like £35 to £40 billion at least of pension money a year would be available for this purpose. Enough to fund a Green New Deal; enough to transform the future of our economy.

And lastly, we need to make our pension funds accountable. I read recently about pension funds being the biggest obstacle to leasehold reform in the UK. If you're familiar with this issue, leasehold reform is essential because there are so many people who bought houses where the ground rent on the property goes up steadily over time, and the service charges are running out of the capacity of people to pay them. They're being basically captured and exploited by corporate landlords who are making their lives a misery, and that supposedly is being driven by pension funds who do not want to give up this right to profit.

This is absurd. The very same people who pension funds are meant to be servicing with a product - a pension on which they can rely - are exploiting those same people to ensure that they cannot make a contribution. Pension funds must therefore be made accountable. We cannot have pension funds harming people today for paper gains tomorrow; that has to end.

Is your pension safe? No, not in the way it's currently managed. Not at all. It's being managed for the benefit of the City of London, not you. It's not being managed with your well-being in mind. It's not delivering the prosperity that you and your community want. It's not providing investment for the benefit of those who will follow you, and who will look after you in old-age. It is fundamentally socially unjust, and that is politically indefensible.

Reform is needed now, but let me make one further last point, and this is not pension advice, it is just a suggestion that you need to think about where you are now. If you are worried about financial markets now, and I think there are good reasons to be worried about financial markets now - I've already mentioned them in this video - then you might want to go and ask your pension fund, your HR department, whoever it might be, or your personal pension advisor, whether there are safer options for savings available for you within your pension fund at this moment.

That is something you may want to do. I'm not saying you should do it. I'm saying you may want to do it. In these uncertain times, caution can be rational, and you need to explore that opportunity. The decision is yours, but if I were you, I would be doing it simply so you know what the options are. In an uncertain world and in a pension system which is frankly stacked against you in very many ways, trying to take as much control as you can makes sense, and at this moment it makes maximum sense. So have a think, go and take some action. Protect yourself.

What do you think? Do you believe in the current pension system? Do you think there could be something better? Do you believe that the state should be delivering for you? Do you actually want them to take over the supply of pensions for everyone? Let us know. There's a poll down below, and let us have your comments because those are valuable to us. They do shape our thinking and where we go with future videos.

Poll

[poll id="306"]