REFLECTIONS ON THE ROLES OF STATE AND OCCUPATIONAL PENSION SCHEMES IN THE UNITED KINGDOM

by

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1. INTRODUCTION

1.1. In recent years there have been substantial changes in the structure and scope of both State and occupational pension schemes in the United Kingdom. In addition, two different Governments have introduced legislation for a fundamental restructuring of the State arrangements which has been frustrated in part or in whole by the results of subsequent general elections.

1.2. With a new State scheme along the lines set out in the White Paper entitled "Better Pensions" (1), issued in September 1974, very likely to be introduced with effect from April 1978, this seems to be an opportune time to attempt to define what should be the objectives of (a) the State and (b) the employer in the provision of pensions and other related benefits for the retired population of the country. At the same time, the opportunity has been taken of re-examining the various proposals which have been adopted or proposed in recent years and considering why these proposals have failed and to what extent the new proposals in the White Paper will assist in the attainment of these stated objectives.

2. OBJECTIVES OF STATE AND OCCUPATIONAL PENSION SCHEMES

2.1. It would probably be widely accepted that the principal "joint" objectives of State and occupational pension schemes were the provision of sufficient benefits to enable individuals to live in reasonable comfort and security when they are no longer able to provide these benefits for themselves by reason of ill-health or old age, and the provision of similar benefits for dependants of such individuals after their death. In this paper we are concerned only with benefits payable in old age and on the death of a spouse.
2.2. A number of fundamental questions arise:

(a) What benefits are required to provide "reasonable comfort and security"?

(b) Under what circumstances should these benefits be payable?

(c) How are the benefits to be split between the State and occupational schemes?

(d) How are the benefits in the different types of schemes to be secured?

2.3. The view might well be expressed that these questions cannot be answered independently. However, if sectional interests, and, in particular, those of what is loosely called the pensions industry are set aside and an independent stance taken, separate analysis of these various points is possible.

The level of benefits

2.4. Taking first what is probably the most difficult question of what level of benefits to provide, it should be obvious, although this is frequently not recognised, that this depends entirely on the available resources. There can be no unique solution to this question but, nevertheless, it would be accepted that there is a range of levels within which the actual amounts should lie. Suggested as a minimum benefit would be something approximating to the present State flat rate pension plus allowable supplementary benefit, i.e. in total, say about £20 per week for a married couple or £15 per week for a single person. Quite obviously, this represents a bare subsistence level. At the other end of the scale, the logical ceiling, if there is to be any ceiling at all, would appear to be a retirement pension not greater than the employee's income immediately prior to retirement, subject to modification in the case of employees who have suffered a reduction in earnings close to retirement.

2.5. It is interesting to note that the Inland Revenue have for many years imposed a ceiling of two-thirds of near final salary on the maximum pension which may be provided from an occupational pension scheme, quite apart from any benefits provided by the State. The reason for this limit appears to be mainly historical and related to the benefits provided in the original pension schemes for civil servants. When this limit was first imposed, State pensions, even in real terms, were negligible. However, with effect from April 1975, the State flat rate pension for a single person is to be £11.60 per week or about 20 per cent of estimated national average
earnings (NAE) at that time while the flat rate pension for a married couple will be about 32 per cent. In addition, an employee joining the State graduated scheme today at the age of 21 could, if that scheme were to continue, accrue an entitlement to a graduated pension of 51p per week for each year of service which after 44 years' accrual would amount to 39 per cent of NAE at estimated April 1975 levels, giving a total State pension of 59 per cent in the case of a single person. This is, to some extent, misleading, since of course the accruing graduated pension is at present fixed in money terms (although under the proposals in "Better Pensions" it would be uprated in line with rising prices) and on this basis the eventual pension would be worth rather less in real terms than is indicated by the above figures. In any event, graduated pensions will cease to accrue after April 1975. Nevertheless, it is now apparently quite acceptable that an individual's income after retirement, from State and occupational pension schemes combined, can be greater than it was immediately prior to retirement. Not only is this acceptable, it is positively encouraged by the Government, in that certain tax reliefs which are widely accepted as being valuable (although this in itself is a matter for debate in actuarial circles (2)) are granted in connection with the operation of occupational pension schemes. This seems to be a nonsensical situation.

2.6. Equally nonsensical are the very complex rules governing the approval of occupational pension schemes by the Inland Revenue which have evolved over many years of discussion and argument between officials of the Superannuation Funds Office and those concerned with the organisation of occupational schemes. The very helpful practice notes issued by the Board of Inland Revenue in October 1970 (3), which set out what the Commissioners of Inland Revenue were prepared to accept in exercising the discretions open to them in considering whether or not to grant approval of an occupational scheme under the Finance Act 1970, contained 275 paragraphs, many of which have since been amended or supplemented and a few deleted. An up-to-date version of this document, incorporating the requirements of the Occupational Pensions Board under the Social Security Act 1973 in relation to the preservation of pensions, is expected to be produced shortly and no doubt that will be even longer and more complex. We understand that the Joint Office of the Superannuation Funds Office and the Occupational Pensions Board now provides employment for about 275 civil servants. Even this number is insufficient to cope adequately with the situation since, as those of us involved with occupational pension schemes are well
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There are frequently very long delays in confirming approval of schemes and even in settling what should be relatively simple matters. This is not intended to be a criticism of the overworked civil servants who man the Joint Office, but an attempt to indicate the futility of the present system of requirements for the approval of occupational pension schemes. Here, we have an opportunity to make substantial savings "at a stroke" by simplifying the whole process of approval.

2.7. There does not appear to be any need for a maximum pension or widow's pension since all benefits payable in pension form are taxable in the hands of the recipient. In the absence of limits, normal commercial practice would ensure that, in an overwhelming majority of cases, pensions would emerge at a suitable level since, of course, as mentioned earlier, any pension must come from the resources available. However, if there is indeed to be a limit on the maximum allowable pension, a suitable simple rule would be as follows:

"The pension payable to a member shall be not greater than the difference between:

(a) his final year's salary (or some similarly defined amount); and

(b) his State pension and any pension from any other pension scheme to which he has previously belonged."

2.8. In the case of tax-free lump sums there is a much stronger argument for the existence of limits. Indeed, given that the object of a pension scheme, whether State or occupational, is to provide the recipient of benefit with an income, there is no reason, on social grounds, for allowing tax-free lump sums at all, except perhaps to a modest extent in the event of death when a surviving dependant frequently has to meet exceptional items of expenditure. The attractions of lump sums on retirement are primarily connected with tax saving and these attractions are likely to decrease with the introduction of Wealth Tax. Nevertheless, the provision of tax-free lump sums is at present an attractive feature of many occupational schemes and up to the existing maxima there is perhaps an argument for maintaining these as encouragement to such schemes. An alternative would be to remove all restrictions on the commutation of pensions but to leave the resulting lump sum payments to be taxed as the government of the day decided.

2.9. Quite apart from any savings in expenses on the part of the supervisory authorities, any far-reaching simplification of the rules
The conditions for payment of benefits

2.10. At present the State retirement pension is payable from the age of 65 in the case of males and from the age of 60 in the case of females. Payment may be deferred if an employee continues to work after these ages, in which case the pension when it eventually starts is increased by a factor which takes some account of the actuarial considerations involved in late retirement.

2.11. The different pension ages for males and females, which are followed by the majority of occupational schemes, are, like the Inland Revenue limits discussed above, largely the result of historical accident. There can be no logic in discrimination of this nature, in this case against males, and it is suggested that a uniform retirement age should be adopted for both males and females under the state scheme. In order to preserve as much continuity as possible, and because of the cost of any reduction in pension age for males, it would seem to be appropriate that this uniform pension age should be 65, at present.

2.12. A minority of occupational schemes have pension ages different from those which apply under the State scheme, although, apart from a few exceptional cases, such as the police and armed forces, Inland Revenue approval is only given to schemes with pension ages not more than 10 years lower than those of the State scheme. This restriction appears to be completely arbitrary and unnecessary and we would propose that there should be complete freedom as to the retirement ages which apply under occupational schemes.

2.13. Turning to the payment of widows' pensions, these are at present only payable from the State scheme in full to widows over the age of 50 or to those with young children. Reduced rates are payable to widows between 40 and 50. These conditions probably represent a reasonably satisfactory compromise between generosity and economic stringency. There are no widowers' pensions payable under the existing State arrangement but this particular area of discrimination is to be removed under the latest government proposals.

2.14. Under occupational schemes, pension benefits may now be paid on the death of a member to a surviving spouse (male or female)
or to any dependant and there is no reason why this flexibility should not continue to be available to occupational schemes. It is interesting to note that, prior to 1973, the Inland Revenue would only allow pensions to be paid to the husbands of deceased female members of an occupational scheme if actual dependency could be established.

The split between State and occupational schemes

2.15. In considering the way in which the provision of benefits should be divided between State and occupational schemes, it is, of course, virtually impossible to exclude from one's mind the existing situation and the proposals which are likely to be introduced in the foreseeable future. In the first place we have the flat rate State pension of £10 per week for a single person and £16 per week for a married couple, on top of which there is the present system of supplementary benefits and the graduated pension scheme. The latter, which shortly (and thankfully) is to be laid to rest, can, for the purposes of this discussion, be ignored.

2.16. There are people who will never have the opportunity of benefiting from an occupational scheme, e.g. the permanently unemployed, the chronic sick or permanently disabled, quite apart from those who are in non-pensionable employment. If people in these groups, other than the few amongst them with private sources of income, are to live in reasonable comfort and security, they must be provided with a basic minimum benefit and this can be done only by the State or by private charity. To rely on charity in these circumstances would, in our view, be completely unacceptable and in any case the State would almost certainly have to operate as a "charity of last resort". We consider that the only practical arrangement is for the basic minimum benefit for people in these groups to be paid by the State. It has already been suggested in paragraph 2.4 that this benefit should be of the order of £15 per week for a single person and £20 per week for a married couple. These amounts should be increased at least once a year to maintain their real value. In a period of severe inflation, such as has persisted over the last few years, more frequent increases would be necessary, a principle which appears to have been accepted by recent Governments.

2.17. The question then arises as to whether similar benefits should be provided for other retired persons with other sources of income. Quite clearly, a means-tested system designed to exclude
such persons from State benefits would have the following disadvantages:

(i) it would be difficult and, therefore, expensive to operate;

(ii) it would be extremely unpopular with beneficiaries and potential beneficiaries, so much so that many would probably refrain from claiming benefits;

(iii) there would be little point in an occupational scheme which sought to provide a modest level of pension for lower-paid employees as this would merely reduce the pensioner's benefit from the State scheme; any schemes providing only modest benefits would be likely to allow full commutation of pensions for this reason.

It should be noted that these disadvantages apply to the present system of means-tested supplementary benefits, although (i) and (ii) could be resolved by the introduction of negative income tax.

2.18. Our conclusion is that the basic minimum level of benefits should be payable by the State to all retired employees.

2.19. A rather more difficult problem is to what extent benefits in excess of the basic minimum should be provided by the State. Why should the State provide pension benefits on an earnings-related basis anyway? This question was discussed by M. D. Thornton, F.F.A., in opening a discussion on the National Superannuation and Social Insurance Bill 1969 (4), when he found the case for earnings-related State pensions "substantially proved—and accepted by both major political parties". That the latter is still apparently the case may in itself be one reason for reconsidering the verdict. We can find no validity in an argument which says that, because an individual had sufficient earnings during his working lifetime to enjoy a certain standard of living, he should be able to rely on future taxpayers to maintain him at something approaching the same standard. The argument is put forward that because of the failure of occupational pension schemes to cover various sectors of the community satisfactorily, e.g. employees in small companies, manual workers etc., the provision of final salary related benefits should be taken over by the State. Is this a fair assessment of the record of occupational schemes? Is the present situation not in fact the result, at least in part, of the attitude of the individuals concerned for whom no retirement provision has been made, and for whom, as a result, the level of take-home pay has been higher than might otherwise have been the case? Yet again, the power of the
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State to regulate the life of the individual is to be extended, not on grounds of social justice, but apparently to protect the individual from himself—in this particular case, from his own failure to make provision (or to persuade his employer to make provision) for his old age to the extent the government of the day feels is adequate. Perhaps this continuous erosion of individual freedom is an endless process even under our so-called democratic free society. Hopefully, however, this may not be so, in which case a suitable area to halt or at least slow the process would be in the field of pensions. A reasonable arrangement, it is submitted, would be for the State to provide a basic minimum level of pension as already described (i.e. the present minimum level plus supplementary benefit) and leave individuals and their employers to provide such additional benefits, perhaps within limits, as they think fit. The provision of such additional benefits should be encouraged as much as possible in the first place by the existing system of tax relief.

2.20. In addition, some government guarantee to maintain the purchasing power of occupational scheme pensions after the commencement of payments, perhaps up to a maximum level, would undoubtedly be an enormous incentive. Any such guarantee would in itself have an inflationary effect, a factor frequently overlooked in discussions about index-linking of prices and wages generally. This, however, would be offset to some extent by any earlier deflationary effect arising from the stimulation given to savings by the encouragement of funded occupational schemes.

Abatement

2.21. If, despite the arguments to the contrary, a new State earnings-related scheme is introduced, the question arises as to the extent to which occupational schemes should be enabled to contract out. If we leave aside the self-interest of all the bodies involved in the pensions industry in the private sector, the only valid argument in favour of abatement would be one which demonstrated that it would be economically beneficial for the country. This of course centres round the advantages and disadvantages of funding which are discussed further in the following paragraphs. In the particular situation of abatement, we are concerned with the possibility of an occupational scheme taking over from the State scheme the liability to provide certain benefits. The actual payments to pensioners are unchanged but as well as making payments to pensioners the occupational scheme also begins to build up a fund out of which to make future payments. To the extent to which this fund is built up out of
real saving with a resulting real decrease in consumption, there could be a beneficial economic effect. What is much more likely is that the extra contributions required to build up the fund result in higher wages and prices to compensate the employees and employers concerned and a further twist given to the inflationary spiral with which we are all faced. It is also relevant to consider the enormous waste of skilled man-power over the last 15 years or more, spent in arguing about abatement or contracting-out terms for various proposed state schemes. If we had been less concerned with abatement with all its complications, the State Reserve Scheme or even the Crossman Scheme might have come to fruition much more quickly, and employees now approaching pension age might have had something more than their existing flat rate and graduated pensions to look forward to in retirement. The waste of man-power does not of course stop with the introduction of the State scheme. It continues forever after, because of the procedures which have to be followed to ensure that every member's rights are secured in exactly the prescribed manner. A. U. Lyburn commented along these lines in a Faculty discussion in 1970 (4) and we entirely support his opposition to abatement.

Funding

2.22. Considering first the question of funding of State benefits, there is no alternative to paying for the basic minimum pension, at whatever level may be agreed, on a pay-as-you-go basis, for the very practical reason that there is at present no real fund in the normally accepted sense. Nevertheless, there is a fund of sorts, namely the whole of the nation's assets from which income is derived to meet the cost of various social projects of which the old age pension is only one. Provided the proportion of income devoted to the payment of the flat rate pension is reasonably constant and likely to remain so, this would seem to be a satisfactory situation. To build up a separate pool of assets to secure the flat rate pension in future would only mean that the current working generation was paying both for existing pensions on a pay-as-you-go basis and for its own future flat rate pensions by additional savings, which would probably be unacceptable. In any event, there can be no means of ensuring that a pool of assets invested in the conventional way will provide sufficient income in the future to maintain the real value of the benefits payable, particularly in an inflationary situation. This can really only be guaranteed, to the extent that it can be guaranteed, by a pay-as-you-go system.
2.23. If, as one must, one considers the possibility, indeed the virtual certainty in the present political situation, that the State will not confine its activities in pensions to the provision of flat rate pensions for all retired people but will also seek to provide earnings-related benefits of some sort, different problems arise. If the new benefits are to be extended in full to existing pensioners, similar considerations apply as in the case of the basic flat rate pension and advance funding is not really practicable because of the enormous cost.

2.24. On the other hand, if the new benefits are not to be extended to existing pensioners but are to build up over a period of years in their application to the older members of the working population, the alternatives of real funding or a pay-as-you-go system are available. The feature of the pay-as-you-go system in this situation is of course that initial contributions are zero but build up gradually as increasing numbers of new pensioners become entitled to the new level of benefits.

2.25. This seems to be potentially a quite disastrous approach, dependent as it is on the ability and the willingness of future generations of workers to pay increasing proportions of their income to meet the cost of pension payments to pensioners. It is all very well to maintain that the rate of economic growth will be such that future generations will be able to afford the additional contributions without difficulty, but surely this is something which must in practice be settled by those in employment at the time. In fact it is beyond the powers of the existing generation of workers to commit future generations to contribute any proportion of their income to State pensions, far less an even greater proportion than the existing generation itself is prepared to do for the current generation of pensioners. Any pay-as-you-go pension scheme set up on this basis is bound to be subject to modification by future generations if it is found to be too expensive.

2.26. Only two possible alternatives for the provision of any State pension in addition to the existing flat rate scheme should, therefore, be considered:

(i) a scheme which immediately applies the new benefits in full to all existing pensioners;

(ii) a scheme in which the full benefits build up over a period but where the estimated level of contributions required to provide
the full benefits on a pay-as-you-go basis is payable from commencement, the excess of contributions over benefits during the period of the build-up to full benefits being available for investment in a similar way to the fund which would have built up under the now defunct State Reserve Scheme.

2.27. Turning to the situation of private occupational schemes, if the beneficiaries are to be in any way insulated from the fortunes of their individual employer it is clear that some type of trust fund, entirely separate from the employer's own assets, must be established. As indicated in paragraph 2.21, however, the effect on the economy of the country is far from clear. Certainly the establishment of funded schemes must contribute to some extent to wage inflation, which must offset at least part of the advantage arising from the availability of a pool of assets for investment purposes. This subject is too complex to consider in depth in a paper of this nature, but perhaps the whole concept of funding pensions on a group basis needs to be re-examined with a view to more responsibility being placed on the individual.

3. RECENT GOVERNMENT PENSION PROPOSALS

3.1. In this section, the various State pension schemes which have been introduced or proposed in recent years are summarised briefly and discussed. Detailed consideration of the proposals in "Better Pensions" is deferred to the following sections.

The Flat Rate Pension

3.2. The present flat rate pension scheme was first introduced in July 1948, largely as a result of proposals put forward in the Beveridge report of 1942 (5), the first and only comprehensive report on social insurance in the United Kingdom, when the pensions payable were £1.30 per week for a single person and £2.10 per week for a married couple. The benefits were financed by level contributions which for males were 24.6p per week by employees and 20.8p per week by employers and for females 19.2p and 16.2p respectively. The levels of benefits and contributions have been altered from time to time, the existing levels becoming effective in October 1974. The present levels for non-contracted-out employees, together with those of 1948 for males revalued in line with price increases up to October 1974, are set out below.
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<table>
<thead>
<tr>
<th></th>
<th>October 1974</th>
<th>1948 levels uprated to October 1974</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td><strong>Pensions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single person</td>
<td>10.00</td>
<td>4.71</td>
</tr>
<tr>
<td>Married couple</td>
<td>16.00</td>
<td>7.61</td>
</tr>
<tr>
<td><strong>Flat rate contributions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee</td>
<td>0.75</td>
<td>0.89</td>
</tr>
<tr>
<td>Employer</td>
<td>1.72</td>
<td>0.75</td>
</tr>
</tbody>
</table>

The reduction in the level of employees' flat rate contributions in real terms over the period involved has been the result of deliberate government policy, with increasing emphasis being placed on earnings-related contributions.

3.3. Notwithstanding the changes in benefits and contributions over the years, the flat rate scheme suffers from the not inconsiderable defects that the benefits are too low to enable a recipient to survive without some further means of support and the contribution basis has imposed a disproportionate burden on the lower-paid employee. The low level of benefit has, of course, been augmented by the means-tested supplementary benefits. The effects of the flat rate contribution on the lower paid were recognised by the introduction of the scheme for graduated contributions and benefits in 1959 and again by the Social Security Act of 1973 as a result of which, after April 1975, all contributions will be on an earnings-related basis. This change in approach strengthened the already almost inescapable conclusion that national insurance "contributions" are a tax. The fact that such "contributions" are to be wholly earnings-related and collected through the PAYE system suggests that the Government has abandoned the pretence that such payments are contributions in the accepted sense of the word.

The State Graduated Scheme

3.4. By the late 1950's it had become apparent that the increases in the State flat rate pension which were accepted as being desirable could not be fully financed by corresponding increases in the flat rate contributions without imposing unreasonable burdens on either the lower-paid employees or their employers or both. A scheme of graduated contributions was, therefore, evolved to finance the increases in the flat rate pension and this was introduced by the National Insurance Act, 1959, and came into effect in 1961. The
initial rates of contribution by employees were 4¼ per cent of earnings from £9 to £15 per week, the employer paying a like amount. In an attempt to compensate for these additional contributions, a scheme of graduated pensions was introduced at the same time, the basis being that a pension of 2½p per week would be payable for each £7·50 paid in contributions by a male employee or £9·00 paid by a female employee. This was supposed to represent value for money on a reasonable actuarial basis for the working population as a whole. However, even on the basis of the value of money at the time the scheme was introduced, the prospective benefits were very small indeed. Given the rates of inflation experienced since that time and the absence of any form of inflation proofing, the real value of benefits secured to date under the graduated scheme has proved to be quite derisory.

3.5. The level of earnings covered by the graduated scheme and the level of contributions have been extended from time to time, notably in 1966 when earnings-related sickness and unemployment benefits were introduced, and the current rate of contribution for non-contracted-out employees is 5½ per cent of earnings from £9 to £62 per week, payable by both employees and employers. For an employee on the maximum level of contributions, the maximum benefit is now 51p per week for each year of employment.

3.6. When the scheme was introduced, arrangements were made for occupational schemes to contract out provided they guaranteed to provide for each contracted-out employee the same pension as would have been earned by a non-contracted-out employee in receipt of earnings at the maximum level covered by the scheme. There was no requirement to provide the widows’ pension entitlements normally earned by graduated contributions. This contracting-out facility was not extended to the higher rates of contribution introduced subsequently as these were required in full to finance the flat rate pension and other benefits on a pay-as-you go-basis and the facility has been restricted since 1963 to contributions of 4¼ per cent of earnings between £9 and £18 per week. The basis on which contracting out was allowed was such that initially the potential savings in overall cost to an employer were marginal when the additional administrative expenses were taken into account. However, the subsequent rise in interest rates made the provision of fixed money pensions correspondingly cheaper, so much so that it has almost undoubtedly become financially attractive to contract out. This situation is now altered by the proposals in “Better Pensions” to maintain the value in terms of prices of any pensions earned in the graduated scheme (but not contracted-out equivalent pension benefits).
3.7. As a method of financing the flat rate pension the graduated scheme of contributions seems reasonable in principle, although in this context it must really be considered in conjunction with the flat rate contributions also payable. The following table shows the combined contributions payable by a non-contracted-out employee and his employer at present and those payable on similar earnings levels (adjusted for inflation) when the graduated scheme was first introduced.

<table>
<thead>
<tr>
<th>Weekly earnings</th>
<th>Total flat rate and graduated contributions</th>
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<tbody>
<tr>
<td></td>
<td>1961</td>
</tr>
<tr>
<td></td>
<td>£</td>
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<tr>
<td>20</td>
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<tr>
<td>40</td>
<td>3.16</td>
</tr>
<tr>
<td>60</td>
<td>3.16</td>
</tr>
</tbody>
</table>

3.8. It seems clear, at least in retrospect, that a number of fundamental errors were made in the introduction of an entitlement to graduated pensions "in return for" graduated contributions.

1. the level of benefits in an inflationary situation was too low to be of any real significance;

2. the notion that State pension contributions are anything other than taxation was perpetuated;

3. the encouragement given to employers to contract out led to the establishment of occupational schemes on a fixed money basis at a very low level, particularly for works employees, which probably deluded many into believing that their retirement provision was greater than was indeed the case;

4. the complications involved in administering the scheme and particularly those arising from contracting out have resulted in a considerable waste of skilled resources which could undoubtedly have been better applied elsewhere.

The Crossman Scheme

3.9. The details of what is now known as the Crossman Scheme were originally put forward in January 1969 in a White Paper entitled "Proposals for Earnings Related Social Security" (6). Two subsidiary White Papers completed the proposals which were consolidated into the National Superannuation and Social Insurance Bill, 1969. Due to the General Election in June 1970 and the subsequent change of government the Bill was never enacted.
3.10. Under the proposals the existing flat rate and graduated pension scheme was to be replaced by a single earnings-related scheme with a two-tier level of benefits. The scheme was to provide benefits based on the average of the highest 20 years' earnings of each employed person, those earnings being uprated in line with NAE so that effectively the scheme sought to provide a pension linked to near final earnings. The pension benefit was to be 60 per cent of near final earnings calculated as above up to one half NAE together with 25 per cent of those earnings falling between one-half NAE and one and a half NAE. The maturity period under the scheme was 20 years and for those reaching pension age less than 20 years after the introduction of the scheme, the additional benefits under the proposed new scheme would be provided on a pro rata basis. Pensions in the course of payment were to be reviewed biennially and there were provisions for a flat addition to the pension payable to a married man in respect of his wife which at outset was to be fixed at approximately $12\frac{3}{4}$ per cent of NAE.

3.11. The contributions to finance the pension element of the proposals were to be at the level of $4\frac{3}{4}$ per cent of earnings up to one and a half NAE by employees and 5 per cent of earnings with no ceiling by the employer. Contributions for benefits other than pension benefits were to be 2 per cent of the earnings described above by both employee and employer.

3.12. There were provisions for occupational pension schemes to contract out of part of the scheme subject to the occupational scheme providing a pension of at least 1 per cent of average earnings for males and 0.55 per cent of those earnings for females up to a ceiling of one and a half NAE. The State pension in these circumstances would be reduced by those amounts and contributions to the State would be reduced on each side by 1.3 per cent of earnings up to one and a half NAE. The State was to be responsible for dynamising the occupational pension up to the above level both before and after retirement.

3.13. The Crossman Scheme, whilst purporting to be a single scheme, was in reality to be two schemes, the pension based on the lower tier being almost identical to the basic State pension. It follows that the contracting-out provisions were such that members of contracted-out schemes would have received their pension from three sources, namely, the basic State scheme, the second tier State scheme and the occupational scheme. This would almost inevitably
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have led to an administrative nightmare. The Crossman Scheme was not dissimilar to that suggested in the White Paper "Better Pensions" but, although as mentioned above there would have been great complications, the terms for contracting out were more attractive financially to employers than those under the proposed new scheme.

Social Security Act, 1973

3.14. The details of the pension proposals of the Conservative Government elected in 1970 first emerged in the White Paper "Strategy for Pensions" (7) published in September 1971 and were subsequently embodied in the Social Security Act 1973. Under these proposals, the flat rate pension was to be continued but the existing system of flat rate and graduated contributions abandoned and replaced by a new system of entirely earnings-related contributions. It was estimated that these contributions would be 5¼ per cent of earnings up to one and a half times NAE payable by employees and 7½ per cent by employers. These rates have since been increased to 5½ per cent and 8½ per cent primarily as a result of subsequent increases in the flat rate pension. As at present, no facilities for contracting out of the flat rate pensions were to be available to occupational schemes.

3.15. In addition to the flat rate pension, the Social Security Act, 1973, covered the introduction of a second State scheme, the State Reserve Pension Scheme, for employees who were not members of recognised pension schemes. Designed on a completely money purchase basis, this scheme was to be financed by contributions of 1½ per cent of relevant earnings by employees and 2½ per cent by employers bringing total contributions in respect of members up to 7 per cent by members themselves and 11 per cent by their employers.

3.16. Contributions to the State Reserve Scheme were to form a fund whose investment policy was to be in the hands of independent managers, completely outside the control of the government.

3.17. The guaranteed benefits under the scheme were calculated by the Government Actuary and, of course, varied with the age of a member at the time of payment of contributions. It was proposed that additional bonus benefits would be granted from time to time,
reflecting the results of periodical valuations of the scheme by the Government Actuary.

3.18. The opting-out provisions were inevitably complicated and also somewhat unusual since for the first time they did not involve guaranteeing at least equivalence with the State benefits lost by members of recognised schemes, as schemes which opted out of the Reserve Scheme were to be called. It seems unnecessary to detail the various recognition tests (8), but it is interesting to note that, as was the case with the graduated scheme at commencement, an occupational scheme satisfying these requirements would have exempted its members entirely from contributing to and receiving benefits from the State Reserve Scheme.

3.19. The main opposition to the State Reserve Scheme arose from the complete absence of any element of redistribution from the younger members of the working population to the older members or to existing pensioners, a feature of any scheme arranged on a money purchase basis. As a result it would have been 40 years before anyone could derive the maximum level of benefit. It was felt that to defer the full maturity of the scheme for such a long period was unreasonable on social grounds. Another element of the scheme which generated adverse criticism was the treatment of women. Since the benefits payable to any member were to be related directly and actuarially to his or her own contributions and those of the employer on behalf of the individual member, the pension payable to a female from the pension age of 60 was somewhat lower for the same amount of contribution than that payable to a male from his pension age of 65. Although this situation was completely equitable on actuarial grounds, it was held in some quarters to be grossly discriminatory against women who were to be required "to pay the same contributions for a lower pension". There were also reservations about the prospect of the accumulation of an enormous invested fund which, in practice, would have been under the control of the government of the day, whatever safeguards were included at the commencement of the scheme for the independence of the investment managers.

3.20. One stated objective which would undoubtedly have been attained by the Reserve Scheme was further growth in occupational pension schemes. Although many of the schemes which were being arranged in order to obtain recognition would certainly have been at a modest level and initially little more than was required to become
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recognised, they did at least represent a step forward and, from past experience, it seems likely that many would subsequently have been improved.

3.21. Despite the various objections, the scheme would certainly have come into effect in April 1975 but for history repeating itself in the form of a change of government at the critical moment as a result of the General Election of February 1974. Nevertheless, it was not until May 1974 that the announcement was made that the State Reserve Scheme was not to operate after all. On this occasion the amount of wasted preparatory work carried out in expectation of the implementation of the scheme was even greater than in the case of the Crossman Scheme and, in many occupational schemes, changes had already been introduced specifically to meet the requirements for recognition under the new Act.

3.22. On reflection, one's feeling is that the State Reserve Scheme could have survived in its original form for a reasonable period only if there was a further substantial increase in the real values of the flat rate pension and supplementary benefits on which the majority of pensioners would have been principally dependent for many years to come.

3.23. Another factor to consider in reflecting on the State Reserve Scheme is the enormous fall in share and property prices since the fully funded basis underlying the benefits was first proposed. Just what would the State do with a fully funded scheme which ran into deficiency or which was unable to produce high enough bonuses to keep pace with inflation? The answer surely is that it would do as is now proposed be done in connection with graduated pensions—it would produce a subsidy from increased taxation (or contributions) or print more money to bring the benefits up to more acceptable levels.

3.24. That part of the Social Security Act 1973 which was not repealed in 1974 contained provisions relating to the compulsory preservation of benefits for members of occupational schemes, who leave service prior to normal pension age. As from April 1975, a deferred pension will have to be offered in this situation where the member concerned is over age 26 and has completed five years' service. Provided his salary has not exceeded £5,000 per annum a member satisfying the above conditions will, however, retain the right to a refund of any of his own contributions paid prior to 5th April 1975 and, as a transitional measure applicable to withdrawals up to April 1980, any contributions paid up to that time also.
4. "BETTER PENSIONS"

4.1. The cancellation of the State Reserve Scheme in May 1974 left the occupational pensions movement in limbo until the publication of the new Government's proposals in September 1974.

4.2. This proposes to retain a flat rate pension at least at its current level in real terms of £10 per week for a single person and £16 per week for a married couple and to provide, in addition, an earnings-related benefit equal to one-quarter of earnings between the level of the flat rate pension for a single person (the base level) and a ceiling equal to seven times the base level. Widows (and widowers) will receive the full single person's flat rate pension plus the whole of the member's earnings-related pension.

4.3. The full level of earnings-related benefits will not be payable until 20 years' membership have been completed. For retirements during the first 20 years of the scheme, the earnings-related benefits would be calculated on a proportionate basis.

4.4. Fundamental to the new scheme is the principle that benefits will be protected against the effects of inflation in the following ways:

1. the base level (and hence the ceiling of earnings covered by the scheme) will be increased annually in line with the general level of earnings;

2. for the purpose of calculating earnings from which to determine the 25 per cent earnings-related pension, each year's earnings will be revalued in line with the general level of earnings. Pensions will be based on the average of the best 20 years' revalued earnings;

3. the earnings-related pension will itself be increased annually after the commencement of payments in line with price increases.

It is particularly interesting in the present economic situation to consider the relative merits of price protection on the one hand and a link with NAE on the other. There seems every chance that for the immediate future at least, price protection is likely to be more valuable to the pensioner and, if this indeed proves to be the case, it seems socially desirable that this protection should be provided up to the base level. To extend full price protection to the earnings-related pension in a period of static earnings, however, increases the inflationary pressures generated by the scheme in a way
which scarcely seems justifiable and we would propose that any post
retirement increase in the earnings-related pension should not
exceed the increase in NAE over the corresponding period.

4.5. As mentioned previously, it is proposed that pensions earned
in the State graduated pension scheme will from April 1978 be given
full protection against the effect of price increases.

4.6. The scheme will be funded on a pay-as-you-go basis, the total
initial contributions at the projected commencement date in April
1978 being estimated at 16½ per cent of earnings up to the ceiling of
seven times base level, rising by about 2 per cent over the next 30
years and by about a further 1½ per cent over the following 20 years
to a total of some 20 per cent. These figures are extracted from the
Memorandum by the Government Actuary which is appended to the
White Paper and are based on various assumptions of which perhaps
the most controversial are that:

(1) earnings will, in future, rise in real terms at the rate of 3 per
cent per annum;

(2) unemployment will be at the rate of 2½ per cent;

(3) 8 million employees will be contracted out of the earnings-
related benefits by virtue of their membership of a suitable
occupational scheme.

4.7. The effect of a reduction in the number of employees con-
tracted out would be to reduce the initial contributions by up to 2·3
per cent but the level of contributions in later years would be very
much less affected by the numbers contracted out.

4.8. It is unfortunate that no official estimates have been published
as to the level of contributions required if different assumptions are
made as to the levels of growth of real earnings and of unemployment.
The contribution rates in the year 2000 given nil growth and 4 per
cent unemployment would be very interesting figures but unfor-
tunately they are not available, nor can they be calculated with any
accuracy without recourse to unpublished official statistics.

4.9. Included in the White Paper are provisions for occupational
schemes to contract out of the earnings-related benefits to be prov-
vided under the new scheme. In order to contract out, a scheme will
in the United Kingdom

have to provide a member with a personal pension payable from normal pension age not less than the greater of:

(1) $1/80$th of suitably defined "final pensionable salary" for each year of pensionable service; and

(2) the amount of earnings-related pension which would have been payable by the State scheme in respect of the period of contracting out, excluding any pension arising solely as a result of the application of the "20 best years" rule which will be payable by the State.

The amount of widow's pension to be provided by a contracted-out scheme is equal to one-half of the above amount, although discussions are taking place as to whether the requirement to provide a widow's pension on death in service might be replaced by the provision of a suitable lump sum benefit.

4.10. A contracted-out scheme will not have to guarantee its pensioners the price protection given by the State scheme as this is to be provided by the Government insofar as it is applicable to benefits actually in payment. When a deferred pension is provided for a member on leaving the service of his employer, that part of the pension calculated as in (2) of paragraph 4.9 will have to be protected fully by the occupational scheme against earnings increases during the period from the granting of the pension up to normal pension age. This particular aspect of the contracting-out requirements is at present the subject of further discussion because of the absence of any form of investment which would enable a contracted-out occupational scheme to match liabilities of this nature, which are subject to inflationary forces outside the employer's control.

4.11. It has not yet been decided by how much contributions to the State scheme will be reduced for employees who are contracted out of the earnings-related benefits, but the estimated reduction is about $6\frac{1}{2}$ per cent of earnings between the base level and the ceiling described in paragraph 4.2, of which $2\frac{1}{2}$ per cent would be applied to the employee's contribution and 4 per cent to that of the employer.

4.12. There would appear to be two extremely strong arguments for an employer rejecting completely the idea of contracting out of any part of the new scheme, firstly administration and secondly cost.

4.13. Taking first the question of administration, many people have had considerable experience of the complications which have
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arisen from contracting out of the graduated pension scheme. There is no reason to believe that the complications on contracting out of the new scheme will be in any way reduced. Indeed, they will almost certainly be greater, since there are a number of areas where the benefits to be provided by the contracted-out scheme will not be identical with those provided by the State scheme where the State scheme will in effect make up the difference. For example:

(1) **Price protection of pensions in payment**

The State is to guarantee price protection on that amount of a contracted-out employee’s pension equal to the pension which the employee would have received from the state scheme if he had participated. Any further pension, whether required as a minimum for contracting out under (1) of paragraph 4.9 or provided in addition by a particularly good occupational scheme, may or may not be protected to some extent, depending on the available funds. How is that to be explained satisfactorily to the employee?

(2) **Members’ pensions**

Here the State scheme will provide any difference between the minimum contracted-out pension as calculated in paragraph 4.9 and the State pension lost by contracting-out arising by virtue of the "20 best years" rule.

(3) **Widows’ pensions**

Again the State scheme will pay the difference between the benefit which would have been paid if a deceased employee had not been contracted-out and the minimum widow’s pension which the contracted-out scheme is obliged to pay. This difference will arise because a contracted-out scheme will only be obliged to provide a 50 per cent widow’s pension and because, in calculating the State scheme benefit on death in service, account is effectively to be taken of years of membership which an employee could have completed if he had survived until normal pension age.

Further complications will arise if arrangements are made for contracted-out occupational schemes to provide lump sum death in service benefits in lieu of widows’ pensions. Hopefully, however, in this area at least reason will prevail and the minimum benefit will have to be provided in income form. Surely the object of the exercise is to ensure that a basic income is available from the State and occupational schemes combined and whilst some flexibility in regard to commutation should perhaps be allowed after the minimum
benefits have been provided it seems quite unreasonable that the widow’s pension on death in service should be the only benefit which may be commuted in full.

4.14. Turning now to the question of cost, it seems clear that, perhaps with very few exceptions, any employer who decides to contract out of the new scheme on the terms at present proposed will be taking a risk which cannot easily be justified in financial terms, given the existing available range of investments for a funded scheme. No such investments can be regarded as wholly satisfactory defences against liabilities which are susceptible to inflation. On the other hand participation in the State scheme will effectively provide an inflation proof investment, subject to the continuing ability and agreement of future generations to bear the necessary taxation.

4.15. We are told in “Better Pensions” that the employer whose pension scheme is contracted out can expect to have his own and his employees’ State scheme contributions reduced in total by about 6½ per cent. This may well in “normal” circumstances represent something like the contribution he would be required to make to provide the necessary minimum benefits through a funded scheme. If his investment manager is very clever or his employees have a peculiar age distribution or if salary inflation is replaced by salary deflation, he may even be able to provide the necessary benefits for 1 or 2 per cent less. However, the probabilities at present seem to lie in the opposite direction and the upside risk, in terms of the increased contributions which would be necessary in an unfavourable situation, is very much greater. It is not difficult to visualise a situation where the contribution required to provide the minimum benefits required for contracting out had risen to 10 or 12 per cent or even higher for reasons over which the employer himself had very little control. Whilst this may be expected to be offset by an increase in the contribution reduction for contracted-out schemes such an increase would inevitably be subject to delay and would have no effect on the cost of accrued benefits.

4.16. It would seem to be likely, therefore, that the introduction of the new State scheme in 1978 will bring about a dramatic change in the role of occupational pension schemes in the United Kingdom. Despite the stated intention of the Government in the White Paper to arrange a continuing partnership between State and occupational schemes, it is unlikely, for the reasons given, that any such partnership will exist to any great extent outside the public sector occupa-
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tional schemes many of which, at the end of the day, are entirely financed from taxation in any event. From being the only significant source of earnings-related pensions, the occupational scheme will change during the maturity period of the State scheme to a vehicle for topping up the State scheme benefits, particularly for white collar workers, to a level which will depend on financial considerations and the limits imposed by the Inland Revenue. In the meantime, it seems likely that any employer with available resources, whether by way of free reserves or pension scheme surpluses, will apply these towards improving the situation of existing pensioners and those retiring during the next few years rather than the provision of improved benefits at some distant future date for existing employees. It is unfortunate that there has been little such tendency in the past, since the low level of pensions now being paid from occupational schemes is one of the reasons advanced by governments for the various proposals which have been put forward in the past for extensions to the State scheme.

5. CONCLUSIONS

5.1. It would appear that the proposed State scheme suffers from the following basic deficiencies:

(1) the fact that pensioners who retire prior to April 1978 will derive absolutely no benefit in excess of what had previously been promised and, indeed, will be worse off to the extent of any graduated or State Reserve Scheme pension which they might otherwise have earned between April 1975 and retirement;

(2) the earnings-related basis of the benefits under the scheme;

(3) the 20-year maturity period before the full benefits under the scheme become payable;

(4) the increasing level of contributions, which even given optimistic assumptions as to the levels of economic growth and of unemployment will rise by up to 3½ per cent of reckonable earnings over the next 50 years, while on less optimistic assumptions the increases could well rise much higher;

(5) the misguided attempt, perhaps for mainly political reasons, to provide for partnership with occupational schemes by apparently enabling such schemes to contract out.

5.2. It is difficult to understand why the Government, and particularly a Socialist Government, was prepared to cancel the State
Reserve Scheme partly on grounds of its very long maturity period in order to introduce three years later another State scheme which not only again does nothing for existing pensioners but also provides little or no benefits to those retiring over the next few years who would have been accruing benefits, however small, from the State Reserve Scheme or, even more likely, from the occupational schemes which would have been introduced to obtain recognition.

5.3. How tragic that, having taken the brave decision to cancel the State Reserve Scheme, the Government should have missed the opportunity to do something dramatic to improve the position of existing pensioners by raising substantially the level of the flat rate pension and leaving the system of occupational schemes to meet the demand for earnings-related pensions through the private sector.

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REFERENCES

SYNOPSIS

The paper considers the role which the State should play in the provision of pensions to the retired population. The role of occupational schemes is also considered with particular reference to the restrictions placed on that role by the authorities through the requirements for approval for tax purposes and the cost and level of State pensions. The main features of various State pension schemes which have been proposed in successive White Papers are discussed together with their shortcomings and advantages. The White Paper "Better Pensions" and its implications for the pensions industry are then considered in greater detail.
Mr. A. J. Low, introducing the paper, said:—Since we produced this paper, there have of course been various publications from the Government and I do not wish to comment on these at all. I think I will leave that to the speakers to do. I would just like to say that I hope we will not become too much involved with detailed discussion about particular provisions of the recent Bill and that we will be able to restrict our attention to general principles as far as possible.

You would notice that in paragraph 2.6 there is reference to the number of paragraphs in the old Practice Notes which turned out to be about the same as the number of civil servants in the Joint Office. We have now got new Practice Notes with 357 paragraphs—i.e. 82 more than the previous version—and I suspect it will not be long before we have another 82 civil servants in the Joint Office.

I think, Mr. President, that is all I would like to say at this stage. I look forward very much to the discussion.

Mr. A. U. Lyburn, opening the discussion, said:—A somewhat hackneyed but popular definition of an actuary is someone who is dead on time. Tonight we have the privilege of debating a paper presented by two actuaries who are very much alive on time. Some may hold the view that this excellent paper is too late. I disagree, because I believe it is too late only after the guillotine has fallen.

In order to help our President call upon as many as possible of those who I am sure will wish to contribute to our discussion this evening, I shall not comment in detail on each clause in the paper, but will confine myself to elaborating on a few points which could perhaps be expressed more vigorously. In doing so, I will bear in mind one excerpt from remarks made by Mr. John Young, our President in 1973, in concluding our discussion on the Social Security Bill which preceded the 1973 Act. "We must never forget that the object is not just to provide an interesting exercise in politics, economics and techniques, but in the final result it is to provide satisfactory pensions for actual people".

Remembering my text I would first like to comment on the level of benefits.

Philosophically I agree it would be desirable to have State flat rate pensions at a level which would remove virtually all existing pensioners, as well as future pensioners, from means-tested supplementary benefits. I think, however, that the figures given by the authors in paragraph 2.4 are low, and that to be realistic for a married couple ought to be somewhere in the region of 40 to 50% of national average earnings. To those who say we cannot afford the necessary level of contribution I would point out that, using 1975 values, the 16½% contribution proposed from 1977 or 1978, after allowing for National Health Service and Redundancy Fund contributions, would be sufficient to increase the joint pension of £18.50 per week by some 18% to a figure of £21.85, which is about 41% of national average earnings, if these are taken as £53.

Thirty years hence the 18½% proposed contribution would raise the pension further to £24.70, which is over 46% of national average earnings. However, even some years ago it seemed that such a simple and honest solution had become politically unacceptable, and that whether we like it or not it appears there will be a State second tier pension which is related to earnings.
The authors next discuss the limits and complex rules administered by the Inland Revenue. It is now becoming more and more accepted that contributions to pension funds are deferred pay and, as the Government does not at present restrict maximum immediate pay, it is illogical that it should restrict total pay. Quite apart from this illogicality, if the restrictions were removed many staff, both in the Civil Service and in the pensions industry, would be released to deal with the documentation and administration which is going to be required when we have the next Social Security Act and Regulations. In paragraph 2.7 the authors suggest a revised rule which I do not endorse because I think it would be no simpler to document or administer than the present rules. However, I agree that there should continue to be restrictions on tax-free lump sums, although again I am not particularly happy at the authors' alternative suggestion that restrictions on commutation of pensions could be removed, leaving the resulting lump sum payments to be taxed as the government of the day decides.

While I have opposed abatement consistently in the past, having first commented publicly in 1967 during the discussion on Mr. Stewart Lyon's paper and again in 1970 as mentioned by the authors, I hope the authors will not feel that I have become a turncoat when I say that my views may have to be modified. Modification flows partly from economic reasons, because if everyone were to be contracted in, which is unlikely, the result could be a reduction in private savings as high as 40% of the £2,000 million which is the approximate current net cash inflow to pension funds. This, however, is an extreme assumption, and even if the contracting-out terms of the Bill are not further modified to ease the anxiety of those of us who are worried about the effects of inflation on pension funds, one must assume contracting out will apply to most employees in the public sector occupational schemes and probably a substantial number of people in other major schemes, particularly where trade unions are concerned. At a rough guess, therefore, opposition to contracting out could lead to a reduction of, say, only 10% of current pension contributions available for investment. Far more important, however, on this theme is I think the need for explicit integration of benefits. Here the Revenue limits come into force and if there were, as I would like to see, no such limits, my advice to an employer may well be to offer employees with a certain minimum service a pension of x% of final pay or average pay revalued, less either all State benefits or earnings-related State benefits, but preferably all the State benefits. Unfortunately this approach may lead to difficulties in defining benefits for early leavers and in administration, but these difficulties are not insurmountable. Overall, however, to be able to carry through explicit integration we will have to maintain very much the same records as we will have to maintain if employees were contracted out, so that whether we like it or not we now seem to be lumbered with a vast increase in administration. Rather than cope with explicit integration difficulties, some employers may prefer to live on top and, while I have an open mind on this point, this approach is not likely to provide a satisfactory final benefits structure and remains open to the dangers of retrospective legislation such as has happened in Mexico, where very generous final pay State schemes have been superimposed on top of existing generous occupational schemes. I understand the Mexican legislation prohibits amendment of the occupational schemes to allow for State benefits, so that members of such schemes will now receive pension benefits far in excess of final pay. This totally illogical situation would not have arisen had the benefits structure allowed for explicit integration.
in the first place. On the other hand, a money purchase plan on top of State benefits could well be an attractive solution to employers who would like to improve on State benefits but who are less sanguine about future inflation than the Government appears to be.

At the end of paragraph 2.25 the authors repeat the warning that pensioners are always dependent upon the current generation of workers for pay-as-you-go pensions. Perhaps one might go further and suggest that, irrespective of any degree of funding, in the ultimate, pensioners as a whole can receive only that portion of consumption which the working population is prepared to give up.

Coming now to the section on recent Government proposals, I mention the Crossman scheme because, like the authors, I feel that the proposals in the White Paper “Better Pensions” are very similar, and also so that I can quote from the Eleanor Rathbone Memorial Lecture given by the late Mr. Crossman in 1972:

“In the end I think I found a relationship with the insurance companies in which I was not selling out to them, but giving them a fair return for their money, while preserving our scheme from becoming so administratively complicated that it would not work. I think we did manage to do it, and though very expensive in terms of administration, it would have just worked. But it was my hope that it would not have to work for more than ten years, since by then more and more firms would be finding it convenient to take the State scheme and merely add a little on top of it.”

I suggest it is pertinent to ask if the Government holds similar views regarding the future under “Better Pensions” and its prodigies and, if not, why not?

I am sure many people in this Hall and elsewhere must share my regret that the proposals in the Social Security Pensions Bill now before us are so similar in effect to the proposals in “Better Pensions”. Great emphasis has been placed on two “concessions”, and while I welcome concessions as showing willingness, I consider the two concessions to be not much more than trivial. In fact I query whether the second concession, that is the offer to buy back under certain circumstances the inflation in excess of 5% for an unspecified premium, is a concession at all. It is true that the contribution reduction has been increased from 6½% to 7% and while one can produce theoretical bases, in fact a whole string of bases, which would produce 7%, no basis I have yet seen seems to me one I would recommend with enthusiasm for the calculation of funding rates. I suggest therefore that, while I appreciate there are constraints on how much the contribution reduction can be increased before the overall 16½% contribution has to be increased, the Government and other interested bodies should sit down and produce a basis which would have more general acceptance. In addition I feel that, to make contracting out viable there has to be a financial incentive to employers.

Turning now to the buy-back terms (other than those for use on withdrawal within five years), it seems to me that, for any block of benefits at any time, the earnings revaluation rate assumed in calculating the buy-back terms should be the same as that assumed in the contribution reduction basis, but that the interest rate should be very close to that current at the time of buy-back, otherwise occupational schemes will have to adopt a very short term investment policy which could make the cost even more prohibitive than at present. This point is not completely divorced from what is by far my biggest worry, that is the effect of
inflation on final salary or average salary revalued plans. Try as I have, I can find no actuarial justification whatsoever for recommending an individual private sector employer to contract out on the basis of the present proposals. True, some concession has been made for what are called early leavers but, as I have already said, that concession could be valueless. In my view what is essential is a limitation on an employer's liability, which can be achieved by setting buy-back terms along the lines I have indicated, allied with a limitation on the amount of guaranteed minimum pension. For active service members this limitation would come into effect only if inflation, after being reasonably steady for a period of time, suddenly rocketed—the situation with which we are not unfamiliar at the present time. I have heard it asked, what is the need for this safety-net? Occupational schemes have coped and are coping now with final salary plans, so why worry about revaluation of active service benefits in line with an index? Well, first, index linked revaluation is to become mandatory instead of voluntary, and second, I need hardly ask people in this Hall tonight how existing final salary plans are in fact coping. Major names have been in the news lately, either because pension funds have received a massive injection of funds or because the employers are saying that, if inflation carries on as at present, pension benefits will have to be reduced because it is not possible to afford both the immediate pay and the deferred pay. Further, if it is accepted that index linking after pension age is uninsurable, and the Minister himself said so on television ten days ago, why is similar index linking before pension age not also uninsurable? In other words, if inflation suddenly jumps from 20% to 50% in, say, 1985, why is it uninsurable in respect of a person who has retired and not uninsurable for a person who has not yet retired? It is not in my view sufficient to rely upon the mechanics of the earnings-related increases taking so long to operate that an employer has time to buy back before an upsurge in inflation really bites. Nor is it sufficient protection to authorise the O.P.B. to permit an employer to pay off by instalments a deficiency arising at any valuation where the value of the assets is less than the value of the guaranteed minimum pension revalued.

I regret this leads me quite bluntly to have to ask whether or not the Government really does want genuine partnership between the State and the private sector. The Minister has repeatedly said so, and we will be hearing from him again tonight, so at this stage it might be churlish of me to press the question. Perhaps the answer is that partnership means different things to different people. Alternatively, is it possible that even now supporters of the 1975 Bill as it stands either do not understand or do not want to understand what inflation can do to a pension fund, or would it be kinder to say that those of us who think we understand have failed to put across the message? If only we could combine actuarial logic with political eloquence perhaps there would be no debate.

You will have gathered the impression that I strongly support the general theme of the paper and the views expressed. We have often heard in this Hall the suggestion that the paper under discussion should find its way into the examination course of reading. My way of saying this, and complimenting the authors, is to suggest that in addition this paper becomes compulsory reading for all politicians and their aides, along with the discussion at our meeting on 19th February 1973, to which I have already referred, and all the other discussions which have taken place during the last ten years or so at the Faculty and the Institute. The more one reads these discussions the more one realises that what is being said now has nearly all been said before several times—most of it is said very aptly in
Mr. President, I would like to conclude in a literary fashion. However, to give quotations without disclosing my source would mislead those here tonight who do not know me and justly earn the scorn of those who do. My source is therefore disclosed as the Oxford Dictionary of Quotations. Being methodical, I started at page 1 and I give the fourth quotation—

"It would be superfluous in me to point out to your Lordship that this is war."

The fifth quotation then caught my eye—

"Think of your forefathers! Think of your posterity!"

and to complete the trilogy, I turn to W. S. Gilbert’s Fallen Fairies—

"In all the woes that curse our race
There is a lady in the case."

Mr. Brian O’Malley, M.P. (Minister of State for Social Security) :-I am grateful for the opportunity which you have given me this afternoon to take part in the discussion of the Faculty on the roles of State and occupational pension schemes. I also think it is extremely useful to have a paper setting out the apparent options open, even if the philosophies underlying that paper are perhaps outside the mainstream of current thought on pension provision. If that be the case, of course, the paper is none the worse for that nor any less useful.

I think we ought to consider this whole issue in the context of the history—the sad history—of the development of pension policies in this country during the last decade and a half, when virtually no progress of any kind has been made, no changes since John Boyd-Carpenter introduced the graduated pension scheme which this paper says (and I agree with it so very much) will disappear in April of 1975 and will certainly not be missed. There has been a history of the two political parties warring with each other on pension provision: the Crossman scheme fell at the Election of 1970; the 1973 Social Security Act or parts of it were scrapped by the present Government during 1974; but, of course, it is always easy to blame the politicians. I don’t mind being blamed as a politician; I don’t mind being told that pensions should not be part of a political football; I don’t like to see pensions or the structure of pensions being tested as part of a game of political football; but, you know, politicians really mirror the complex attitudes and ideas of organisations and individuals outside of Government, and the truth about both the Crossman scheme and the proposals in the 1973 Social Security Act was that both of them were bitterly opposed by whole sections of the community both in 1969-70 and again in 1973-74. When I went into the D.H.S.S. in February 1974 it seemed to me that one of the overriding principles which I must take into account in attempting to draft any pension scheme was that we should try to bring to an end a decade and a half of dissent and disagreement, not only between the political parties but within the country as a whole, and, therefore, in drafting the White Paper, “Better Pensions” on which the Bill is based, the Government was seeking some consensus on the general future structure of pensions in this country and, inevitably, that structure has to take into account the National Insurance Scheme on the one hand and private occupational pension provision, whether in the public or the private sector, on the other, and it is the case that when the “Better Pensions” White Paper was published in September of 1974
White Paper was given a very broad measure of welcome, and I think it is significant that it was welcomed by the T.U.C. and it was also welcomed by the C.B.I. There was therefore room for optimism at that time that we could establish a general structure on which there would be general agreement in British industry by the time the Bill was enacted. Of course, it will be the case that we will never be able to establish a system which in all its details is acceptable to every company or every individual in the country, but the task during the Committee proceedings of the Bill must be to build on the measure of consensus and agreement which is already being reached. And I think, therefore, when alternative solutions are put forward or alternative suggestions are put forward as they are put forward in this paper, which is the the basis of our discussion this evening, it must be borne in mind that we have gone far along the road to establishing a degree of consensus which goes wider than the consensus between the political parties on the broad general future structure of pensions, and to turn our backs on that now would mean that we were opening ourselves up as a nation to at least another decade of argument and discussion. The time for discussion on what the general structure should be, Mr. President, I think should be over.

May I turn now to the paper which has been produced by the two members of your Faculty. The paper begins by setting out the objectives of State and occupational pension schemes and in paragraph 2.1 it begins, "It would probably be widely accepted that the principal ‘joint’ objectives of State and occupational pension schemes were the provision of sufficient benefits to enable individuals to live in reasonable comfort and security when they are no longer able to provide these benefits for themselves by reason of ill-health or old age. . . . " I think that the objective would be agreed by everyone in this Hall, and by anyone interested in the subject of pensions in this country or elsewhere.

The paper then goes on to set out a flat rate solution, that is that the State should confine its activities to establishing a basic flat rate pension and leave any earnings-related provision on top of that flat rate to be provided through occupational pension schemes. Now may I say at the outset on that, both major political parties in successive Governments have examined that proposition, and examined it in considerable detail, and both major parties have turned it down. I think it really is necessary to spell out the reasons why that has been the case.

I want to deal with this as well as the general subject of better pensions because, on your suggestion, Mr. President, I am making a very general speech this evening and basing it on the paper which we have before us for consideration.

Both major parties in successive Governments turned down the simple flat rate solution on the grounds that all people within the community, because of the nature of their employment and reasons applying to individuals, could not have a second earnings-related occupational pension and that, therefore, it would be intolerable to create two nations in retirement: those who had an earnings-related occupational pension on top of a flat rate state benefit and those without it. I think that it should be pointed out that in one section of the paper we are considering there is the suggestion that the State might conceivably guarantee the purchasing power of such occupational pension schemes in a position in which not all members of the nation were members of occupational pension schemes, and quite clearly, on the grounds of equity alone, no Government could find itself in the position where it was able to do that. But I think that the basic reasons why successive Governments (and I think perhaps the mainstream
of political thought on pensions) have turned down simply the flat rate solution, viz. that the State should merely provide that flat rate pension, are these:

It is suggested in the paper that there should be this flat rate pension set at a subsistence level which would be, as illustrated in the paper, at the level of £15 a week for a single person and £20 a week for a married couple, paid to all people over pension age. The cost of that proposition—and the details are not set out in the paper—would range from a minimum of £1,315 million in a year to a top level of £2,825 million, and would therefore involve contribution increases into the National Insurance scheme ranging from 2½% to 4½% on top of the existing 14% earnings-related contributions payable from April 1975. I believe that it particularly needs pointing out that this would be bound to have an effect, and a major effect, on prices, on the levels of wage settlements, and would sorely affect so many companies who have severe liquidity problems, particularly in 1975. Another objection to the flat rate scheme is this. It is always assumed that one can put up the flat rate by a significant amount and either leave supplementary benefit levels where they are or put them up by a lesser amount, and I say to this Faculty, Mr. President, it is not a political starter. No Government will find itself able to do this, for one very simple reason, because it would mean that the major increases would be going to those people who by definition would be less poor, simply because they had an income in excess of the levels set by the Supplementary Benefit Commission. I would also submit to the Faculty that such a scheme would represent a wasteful use of resources on people who had retired with very good occupational pension schemes, perhaps from a high level of final salary. We could use those resources so much better and I think there are higher priorities for the use of those resources, certainly within the Department of Health and Social Security, and I would say even within my side of the Department, on purely the Social Security side of expenditure.

It is also mentioned in the paper that the State scheme is to be on “pay-as-you-go” and I think I ought to make clear what the Government’s attitude is on the whole question of funding and “pay-as-you-go” and it is this. I do not think there is any dogmatic reason, no reason of political principle, why a Government should accept or adopt one method of financing benefits or another. The blunt fact is that we have eight million retirement pensioners in this country, no inherited fund from which to pay those pensions and therefore to the extent that one funds a national insurance scheme, to that extent the level of total contributions required at any one time, certainly in the foreseeable future, is made higher than it would otherwise be. However, I did welcome one comment in this section of the paper which, in dealing with the level of benefit and concluding that any logical ceiling of pension should be not greater than the income immediately prior to retirement, the paper went on to make the reservation that any such ceiling might be subject to modification in the case of employees who have suffered a reduction in earnings close to retirement. I certainly agree with the need for special consideration for such employees.

The “Better Pensions” Bill brings in a new high level of security in retirement for men and women whose earnings drop sharply in the later years of their working lives. This is a special and valuable feature of the scheme. Pensions based solely on income from the final years of employment may be ideal for those whose real wages and salaries reach a peak in those years, but many men earn their best wages earlier in life. Manual
workers often have to take a lighter job on less money in their fifties and sixties because of indifferent health or disablement. To help such employees, their pension will be based on the best twenty years of earnings. Men and women will benefit from that formula whether they are fully in the National Insurance scheme or in a good occupational pension scheme. The formula can be simply illustrated. To take a man on light work who has been earning in today's money values about £30 a week for the last ten years, but for twenty years before that was in a skilled job where he averaged £50 a week (again in current earnings values) over twenty years, he will get a pension based on the £50, not the £30. This, if he is married, will give him a pension of £28.10 a week, just about as much as he was earning before retirement.

Can I next, Mr. President, turn to the section of the paper which deals with the whole relationship and the nature of the partnership between the National Insurance scheme, the State and occupational pension schemes. It is suggested towards the end of the paper that the attempt to achieve a partnership between occupational pension schemes and the National Insurance scheme is a misguided attempt perhaps for mainly political reasons. And can I say immediately—guilty. Of course it is for political reasons: political reasons in the widest sense. I went in to that Department in 1974. What is the situation which I found? (Of course I was aware of it before I got there, Mr. President: I had done some work on this subject before!) We had eleven million people, on the last figures that I have seen, in occupational pension schemes. Eight million of those people are in final salary schemes, the overwhelming majority of which provide accrual rates of eightieths or better, and nothing has been more remarkable in the last decade in the occupational pensions world than the rapid growth and development and coverage of final salary type schemes. The members of those schemes, naturally and rightly, prize membership of those schemes highly. They are worth having. The schemes, because of their nature, have in-built pre-award dynamism based on the earnings record of the individual. Good occupational pension provision, of course, has a flexibility which a State scheme, providing for very much larger numbers of people, cannot provide. Good occupational pension schemes have an important role to play in the general levels of savings in this country and so, of course, there is a political reason. One would not want to destroy or damage the development of the occupational pensions movement in this country. Now, I heard Mr. Lyburn, when he was up on this platform a few moments ago, referring to that often quoted sentence of Dick Crossman. It has been quoted at me many times. He asks for an answer, and I think I have already given him an answer in detail and I repeat it, that the Government wishes to see occupational pension funds, occupational pension provision, having a thriving and a growing future for two reasons. First of all because they are valuable to the individual citizen in retirement (and no-one looking at the failure of the present arrangements when we have two million pensioners having to depend on means-tested supplementary benefits, over one-half of elderly widows, would not agree that it is a good thing that we should improve and increase the value of pensions put into payment at retirement) but in addition to that these schemes are important to the economy of the country, and we therefore see them as having a continuing, a thriving and a growing role in the economy of this country and in total pension provision in the future.

Now, the paper goes on to consider the general question of abatement and the nature of the "Better Pensions" scheme. There would still be those who would argue against the whole principle of abatement or con-
tribution reductions, but I think that I should point out that the whole
worthy idea of contribution reductions is, of course, to make it easier
for employers and employees to develop through collective bargaining
good occupational pension schemes. But the value of abatement is this.
As from April 1975 the total level of contributions payable into the National
Insurance Scheme is 14%. With the inception of the "Better Pensions"
legislation it will rise on the basis of the Bill to an illustrative 16½%, but
those who are in good recognised occupational pension schemes will have
a total contribution as between employer and employee of 9½%, which
represents for both employees and employers, particularly with higher
levels of earnings and salaries, a substantial reduction in contributions
which will be payable as from April of this year, and one would have thought
that that would give an incentive and an encouragement, quite apart from
the separate question of the contracting-out terms, to employers and to
employees to push forward for the development of occupational pension
schemes. Certainly it would be the case that if there were to be no system
of abatement there would quite clearly, if occupational pension schemes at
their best were to be kept at present levels, be serious implications for
wage inflation, for the levels of prices and, again, on liquidity. There is a
further important factor. If there is no system of abatement, it seems at
least not inconceivable, and perhaps highly possible, that there would be
a cut-back in occupational pension schemes. As for the merits of the
Crossman Scheme—I am bound to say, Mr. President, I remember going
out and speaking, when I had been an Under-Secretary at the D.H.S.S.
for only three weeks, on the Crossman Scheme and being confronted with
2,500 angry N.A.L.G.O. members, and they were succeeded by equally
angry meetings of fire brigade members and members of the Police
Federation. I never noticed at the time that the Crossman Pension
Scheme was given an overwhelmingly favourable reception, certainly by
the members of occupational pension schemes, and certainly what Crossman
did involve was a cut-back in the type of provision and the level of
provision made by occupational pension schemes, and I say very frankly
that it was not my intention, rather did I have a reverse intention, to
bring about a cut-back in the level of occupational pension provision which
was an inherent inevitable feature of the Crossman proposals.

Now, the paper goes on to suggest that employers might reject the
concept of partnership as it is set out in "Better Pensions" because of
complications. I have tried to make this scheme as simple as possible and
wherever I have spoken I have said, "Of course, I understand that pro-
fessional men like yourselves understand better than an amateur like myself
that pensions are complex matters". It should be an aim of any Govern-
ment to try and make the basic "guts" of the scheme as simple as possible,
and I have tried to do that. But, of course, any integrated partnership
brings complications, but it is precisely the features which the paper sets
out as complications which we in the Government see as acting as an
encouragement to occupational pension schemes in their relationship with
the State. For example, post-award dynamism. Why should we do it?
Because it was an uninsurable risk. Because the history of the occupational
pensions industry has shown quite clearly that while inflation proofing can
be provided on an ad hoc basis or 3% or 5% per year, private occupational
schemes cannot by their nature guarantee that they will be able to provide
post-award dynamism. And, therefore, in asking for guarantees on the pre-
award dynamism, it seemed to me that we were giving considerable assis-
tance to occupational pension schemes by not requiring any post-award dyna-
mism on those schemes within the parameters of the State arrangements.
It was for similar reasons that we made the provisions that we did on the best twenty years formula, on the type of widowhood pension and on invalidity pension. We have tried with the $\frac{1}{2}\%$, which is to go entirely to the employer, and with the concession under the preservation requirements, to meet the views which have been expressed in consultation with the representative organisations over the last six months. I am bound to say that the issue that was raised with me time and time again by the organisations was first of all preservation—preservation was the one which caused the major difficulty and the major disputation on this subject—and the formula we have adopted I believe is a fair one. I would hope to have within the very near future some illustrative actuarial tables to demonstrate how we would envisage the preservation requirements should work and, of course, I would be very willing to listen to and consider any representations which are made on that subject, both in Committee Stage in the House of Commons and afterwards. Of course, when it is suggested that employers will not want to contract out because of cost, we have already got eight million people in final salary schemes. There is now this extra $\frac{1}{2}\%$ to the employer and, you know, since the crucial question is the difference between wage inflation and investment yield, it is interesting to notice that the Government Actuary sets a 1% difference between wage inflation and yield in his estimates, but only recently the Prudential Assurance Company, merely as a general indication (and I do not say it has the same type of status or even has been used for the same reasons as the Government Actuary’s estimates), is advising, I understand, employers for long-term purposes that the percentage between wage inflation and yield should be 2% which, of course, is significantly higher than the estimates on which the Government Actuary has based his figures. Now, I understand the difference between the two figures and what they are to be used for but I think that it is worthwhile for illustrative purposes to make that point.

There is one last point, Mr. President. Whether schemes are to be contracted in or out, whether they are to be cut back or wound up is more than a question of cost. It is an integral part of the whole problem of industrial relations in this country, and I do not believe that employees generally and their representative organisations would sit back and allow occupational pension schemes to be wound up or severely cut back easily, and I think that this is bound to be an important factor in any of the discussions which have taken place.

So, may I conclude, Mr. President, by saying what the Government is anxious to do (and I do not mind listening to advice telling us we are misguided—I like vigorous debating). We are genuinely seeking a fruitful partnership with occupational pension schemes. We are working on the assumption that those in occupational pension schemes do not wish to see any cut-back of those schemes. I do not envisage a situation in which occupational pension provision in this country reverts to the situation which we find in some other Western European countries, where those schemes merely sit and live on top of a very large State scheme. I believe that there is a far bigger and more important role for occupational pension schemes in the future and I will be prepared to listen to any propositions which are put forward to me. I know, for example, that one of your members, Mr. Gwilt, has put detailed propositions to me and I have said to him, “Of course, I will consider any propositions which are put forward.” I want to get this Bill through the House of Commons, through Committee Stage, emerging as a Bill in which there has been general consensus on the broad outlines of the scheme, even if we cannot agree on everything.
I want the Bill through the House of Commons and the House of Lords before the Summer Recess. I hope that we shall be able to make a 1977 start. I want to get a structure that will last. The sooner we can start that structure the better; the better for those people who can be building themselves up higher pension levels for their future requirements; and I would invite, and I am sure I shall have it, Mr. President, the co-operation and advice of this Faculty. I shall always be willing to listen in detail to any comments or representations made by this Faculty representing the profession in Scotland. I hope that, with the co-operation of all parties in Parliament, and with organisations of all types in the country who are interested in pensions, we shall be able to establish this time a lasting structure and to bring to an end a barren period of a decade-and-a-half during which no progress has been made in establishing a firm basis for pension development in the future.

Mr. J. A. Cairns:—I would like to thank the authors firstly for their very good paper which summarises the position during the last 20-25 years, and it was very interesting to hear Mr. O'Malley giving the background to the present proposals.

Like most actuaries engaged in pension matters these days, I am hoping that we have now entered the home stretch of the "Uncertainty Stakes", even if the result is not what one might have wished for.

There seem to be two main requirements with regard to a Government's scheme which includes an attempt to encourage good occupational schemes. The first is that its own scheme must provide lower benefits than a good occupational scheme. A good occupational scheme must, therefore, expect to pay a much higher contribution into its own fund than the extent of any abatement which it might receive should it contract out, and this point, I am sure, will be a source of misunderstanding for years to come, but I hope that the truth will show through.

The second requirement is that the level of abatement, in terms of contributions, must be worth more than the benefits which would otherwise be provided by the State. When I say "worth more", I am not attempting to state how much more but there should at least be a very small margin in favour of the contracted-out scheme, otherwise, it seems to me that a Government will not be giving such encouragement to the setting up of good schemes as might otherwise be the case.

There is no doubt that actuaries will be able to argue for the next hundred years on whether the abatement terms are appropriate or not and one can only live in hope that they will be. At present, we only know about the first instalment. I would, however, like to discuss some of the problems which I see during the next few years when advice, one way or the other, will be given to employers from all directions.

Undoubtedly, the main problem about funding of existing schemes at the moment is inflation, and it seems to me that this factor virtually eliminates any chance of a small employer contracting out of the State scheme. One can do endless calculations on the effect of various salary progressions during an employee's lifetime, but if he is the sole member of a scheme there is really no safeguard should there be a salary increase of 20 to 30% within a few years of retiring age and the employee has a considerable amount of service ranking for pension on a final salary basis. This, to my mind, virtually rules out contracting out for such employers and leaves the question about the extent to which risks can be spread in larger schemes. If, however, the terms of abatement are such that the contributions abated are worth slightly more than the benefits, it could
be argued that small employers are being treated unfairly in this respect by not really being given the option of whether to opt out or not. In larger schemes, it seems to me that one must look not only at the scale benefits but also at the pace of future funding. If a large scheme has pensions based on sixtieths of final salary and the funding rate is not cut to the bone, then I think one could feel reasonably confident about recommending contracting out, should the employer so wish. I would feel happier also if the pension was based on the average salary over the last few years of service so that, although some of the effects of late inflation are ironed out, there is still a reasonable gap between the scale benefit and the guaranteed minimum pension.

Furthermore, in a large scheme where there is reasonable stability about the number of retirals and withdrawals, one is probably able to ride the effect of short bursts of inflation, but whether one can stand 20% per annum inflation for many more years really depends on the extent to which long-term investment yields remain high, and to this extent any restraint on dividend or rent increases arising from good investments could well defeat the object of the Social Security Pensions Bill.

In the medium sized scheme, more margins to ride unexpected fluctuations are needed and the question is whether these should be built up as early as possible—or more gradually. I for one feel that retaining some margin as early as possible may be inevitable if the O.P.B. is to be satisfied, especially if inflation is still on the rampage in 1978-1980. However, the effect of too much caution on the part of advisers could again prevent employers starting, or even maintaining, good schemes. The timing of the Bill to this extent is unfortunate and calls for some relaxation of requirements, at least as an interim measure, to meet conditions which might otherwise have been imposed in more stable times. We now know some of the worst factors that can influence pension provision and there will have to be mutual understanding between all parties if the best solutions are to be found. Ideally, the Bill should have been introduced with inflation at a lower level. What would be disastrous for administration, if nothing else, would be for the majority of good schemes to be so frightened by inflationary effects that they reduce benefits and contract in until inflation is conquered and then contract out on their old scales of benefit. There is also a danger that inflation will scare many employers from starting good schemes and if they do start schemes at all they will be for the provision of lump sum cash benefits rather than for higher pensions, and one wonders whether this is something that the Government really wants to encourage. Many existing pension schemes could also switch to cash schemes.

There is one other problem which I would like to put to the meeting—although I must admit that I do not, as yet, see the solution. (Mr. Lyburn has already touched on this point.) It is another of those problems highlighted by recent financial circumstances and, although one hopes that the economic uncertainties of the last two years will not recur, they have happened and one must do what one can to put a pension fund in the position where it can meet its liabilities in any similar circumstances. I refer to the payment on termination of contracted-out employment during the first five years. This appears to be 7% of the appropriate earnings since contracting out started. If one bears in mind that stock prices had within a very short period lost nearly two-thirds of their value, then one must reconsider the amount of short-term investment to be made by a pension fund. This, to my mind, has fairly serious implications because I do feel that pension fund investment management must try, as far as
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possible, to aim for long-term objectives. If one has high long-term interest rates when inflation is very rapid, then one may simply have "missed the boat" if one has had to invest short for the potential liability for recent entrants. Possibly I am being a bit gloomy in this respect, but if trustees decided to go for the long-term objectives and the employer collapsed—and we have seen several major collapses during the last few years—the funds could be quite inadequate at the date of termination, even although they would have been sound for a continuing scheme. If terminations are likely to be at their highest when the Stock Market is at its lowest, would it still be possible for the Redundancy Fund to meet the bill? It also seems to me that this problem is at its worst in the initial years of a fund's existence so that if a new scheme is going to start it would be better to do so now rather than wait till 1978.

Finally, I would add my own plea to the Inland Revenue to think again about simplifying their one hundred pages of Notes on Approval under the Finance Act 1970 on this, that and the next thing. It seems to me that they simply encourage so-called flexibility to the detriment of administration, and trying to find sufficient staff who can understand them in any detail is getting well nigh impossible. If they are made even more complicated as a result of this Bill then the Revenue will have to realise that many mistakes will be made by pensions administrators.

This prompts me to ask, why put a limit on pensions? What are the Inland Revenue worried about if they get their £ of tax, in the end?

I would, however, like to put forward one very simple suggestion, which is possibly to put a limit of £40,000 on the amount which a retired employee can draw in any one year, and that he should be given the power to appoint one tax-free year. I think that many simple suggestions like that will have to be considered by the Inland Revenue and the more suggestions that we give them now perhaps the more likely are they to find one simple one that will suit.

Mr. L. W. G. Tutt:—In this evening's most interesting paper by Messrs. Low and Felton there is reference in paragraph 3.19 to reservations which were held concerning the prospect of the accumulation of a large invested fund which in practice, according to them, would have been under the control of the government of the day, had the previous proposals of the Conservative Party come into being. However, these proposals have, in the event, been scrapped and now the financial power to be associated with a funded State scheme may appear to have been somewhat casually cast aside under the Social Security Pensions Bill 1975 by its Labour Party originators.

Does this give rise to a thought that the partnership proposals presently being made by the State to occupational schemes ought otherwise to be considered carefully?

Indeed is it relevant to ask whether by their recognition, as for example in the White Paper "Better Pensions", of the important contributions to savings made through the funding of pension schemes, and yet despite that recognition themselves adopting a basis of assessmentism for their own State scheme, some future imposed investment constraint on private schemes is tacit? Such as for example may be involved by official appraisal of capital formation needs as a spur to real industrial output; support, as a long term practice, of sponsored ideas for floating industrial capital being implicit.

The question is valid. Where are we to look for a clue as to a possible answer? Perhaps the Report recently submitted to the Secretary of State
by the Occupational Pensions Board (Cmnd 5904). May I quote from that Report. In it it is stated that we (that is the Board) hope that it might be thought appropriate to refer to the Board as a long-term study, over, say, 5 years, the question whether it would be appropriate to legislate for funding and investment controls.

In fact, in the United States the Employee Retirement Income Security Act of 1974 has, of course, already introduced in that country minimum funding standards and the concept of a Pension Benefit Guarantee Corporation, and so on.

May I go on to add that the British 1975 Bill suggests in a number of ways the granting of quite wide powers of influence to the O.P.B. For example there is a requirement for the Board to continue to supervise the financial arrangements of occupational pension schemes even after a contracting-out certificate has been cancelled or surrendered, so long as the scheme is responsible for any guaranteed minimum benefits; and as regards Part 4 of the Bill, which is headed Occupational Pensions, any proposals by the Secretary of State to make regulations need to be referred to the Board.

In paragraph 4.16 of their paper Messrs Low and Felton refer to a likelihood of a fairly imminent dramatic change in the role of occupational pension schemes in the United Kingdom. Mr. President, may I submit this evening that the current position calls for realism and vigilance.

Mr. H. W. Gillon:—I think the authors deserve our thanks tonight for identifying a number of defects in the present relationship between State and occupational pension schemes and I would like to elaborate on one or two of these points.

Firstly, I would like to support both Mr. Lyburn and Mr. Cairns on the senselessness of many of the Inland Revenue's restrictions on occupational pensions. The authors have explained that a limit on the amount of pension is unnecessary, as pensions are taxed and the rate of tax on the top slice of the larger pensions is often higher than the rate of tax relief that had been granted on the contributions that financed them. It seems to me that the Revenue have established a vast army on the edge of a cliff in order to destroy lemmings. If they were to abandon some of these futile restrictions, not only would they release a team of skilled staff at Apex Tower for productive work elsewhere, they would also release those in the pensions industry who have to waste a lot of their time trying either to satisfy or to outwit the Revenue. I sometimes wonder which is the more difficult. However, like Mr. Lyburn, I cannot support the alternative limit on pension which the authors put forward in paragraph 2.7, as I think it would create as many problems as it would solve. We should go the whole hog and press the Government to drop the limit altogether.

Then there is the question of the retirement age under the State scheme, which inevitably sets the standard for occupational pension schemes and fixes the age by which most employed people are expected to retire. In my view there is an unanswerable argument that the retirement age should be the same for both sexes, probably 65, and I do not really see that a move in that direction would be difficult to achieve, particularly if there were transitional arrangements. Would many women not welcome the opportunity to work on for an extra five years, drawing full salary and earning five years' additional entitlement to earnings-related pension in the process? Experience among women who are not in ordinary employment indicates that they do not necessarily want to retire at 60 and that they are capable of performing very useful work beyond that age. One
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thinks in particular of a certain 63-year-old Cabinet Minister. If one accepts the view that the average woman in her early sixties is at least as able to perform a good day's work as a typical man of the same age, one can see that different retirement ages for the two sexes constitute an unsound foundation for pension schemes. To build on that foundation a superstructure incorporating sophisticated earnings-related benefits, contracting-out terms independent of sex and equal access to occupational schemes for both sexes is less than prudent, however desirable these features themselves may be. The foundations must be made sound before they can be expected to support the extended superstructure; the Bible tells me so.

The authors refer to the Government's proposal to take power to protect graduated pensions against price inflation, but they do not comment on it. This move seems to me to represent the worst form of retrospective legislation, as it discriminates against those who were contracted out. It is rather like deciding last Saturday night that a penalty goal should have counted four points and a try only three, and awarding Scotland the Calcutta Cup as a result. I am not too concerned about the effect in the case of graduated pensions themselves, as the amounts involved are relatively small. But a vital principle is at stake. If the principle of retrospective legislation is admitted on this occasion, how can we assess the contracting-out terms offered under the Government's new proposals? How can we have the confidence to enter into any future partnership with the State?

I would like now to refer briefly to the Occupational Pensions Board's recent report on the questions that Mr. Tutt referred to. Reading the report I was both impressed and depressed; impressed by the thoroughness of the Board's investigations, but depressed by the prospect of further statutory controls on occupational schemes. I am particularly concerned about the effect on small employers, and I think Mr. Cairns shared my concern, although perhaps for other reasons. The amount of paperwork necessary to establish a scheme and the time and effort required in keeping a scheme up to date are already formidable and relatively most onerous on small employers. Large employers may be able to take further legislation in their stride, but I suspect that some small employers will find any additional requirements so unbearably onerous that they just throw in the towel. That would be unfortunate and it would defeat the Government's declared intent to encourage the development of good occupational schemes. It would be tragic if further legislation intended to protect the interests of scheme members meant that more people were to be denied the opportunity of ever joining an occupational scheme, but that is a real danger.

One final point. The Board has recommended that the Department of Trade should be asked to consider the possibility of extending their proposed guarantee scheme to provide 100% protection for guaranteed minimum pensions in the event of the liquidation of an insurance company. I cannot see that it is equitable that an employer who chose to invest his pension scheme contributions with a badly managed insurance company should be rescued, even to the extent of 90%, whereas an employer who operated a privately invested fund which ran into difficulties because of unsuccessful investments would have to bear the liability himself. If any assistance is required, I would have thought that it should have come from the Government which licensed the insurance company to operate in this field. The last people who should be required to bear the cost are the with-profit policyholders of prudently managed offices—offices
which had not contributed to the failure of a competitor or had any means of preventing that failure. I think this highlights the folly of the whole concept of the proposed guarantee scheme; but that, Mr. President, is another story.

Mr. G. D. Gwilt:—The authors of tonight's paper have shown how much time has been wasted by so many of us by the abandonment of one State scheme after another. This has been mentioned by Mr. O'Malley as well. You must all be very grateful therefore that this time the Conservatives have stated their agreement with the broad principles in Better Pensions and have indicated that they would not seek to change legislation provided its details were acceptable.

It is also very heartening that the Pensions Bill contains some changes from 'Better Pensions' as a result of advice given by the various pensions organisations, and Mr. O'Malley has indicated that possibly there might be more changes in the Bill. And in fact there is one particular area where more changes are needed, and I want to talk briefly about that, if there is indeed going to be the desired partnership between private schemes and the State. An employer who contracts out of the Pensions Bill, if it becomes law as it stands, faces possible bankruptcy as a result. Why is this?

1. The O.P.B. must see that a contracted-out scheme's assets are sufficient to buy back the Guaranteed Minimum Pension—GMP if I can call it that. This, for those who are interested, is in Section 38 of the Bill.
2. An unanticipated increase of National Average Earnings, could, in one year, increase the liability for the accrued GMP beyond the size of the fund.
3. The market value of the assets of the fund—as Mr. Cairns mentioned—could decrease over the same period. This will very likely give rise to a deficiency.
4. The employer is liable for just this deficiency (Sections 38 and 44). He could not simply discontinue his contributions to the scheme and absolve himself from further liability as he can at present.

Now there is a solution to this problem, and in fact I think that there are two essential ingredients to any solution which is going to work. There may be other ingredients too, but no solution will work unless the following two ingredients are put in—

(a) limitation of the amount of the GMP, and
(b) a linking of the buy-back cost per unit GMP to current investment yields.

The latter is obviously necessary to cover fluctuations in the market value of the fund.

I want to go on to discuss the limitation of GMP. A precise statement of my proposed method is in fact easier to follow on the printed page, so, if I may I will save time and leave it for the published transcript.* However, roughly speaking, the upper limit of GMP in my method is obtained by revaluing each year's earnings up to pension age at a rate fixed at the time the earnings were paid. Put like that the limitation looks very much like the old suggestion that the State should guarantee all escalation over 5%.

This is not so and I hope to make two comments which will show this is not so.

* See opposite page
1. An important element is that no limitation would occur if the pension provided by the scheme exceeds GMP. (There is no point in limiting GMP if it has already been provided by the scheme.) This effectively means that GMP is not limited for members who retire from service although limitation can occur when frozen pensions are paid.

2. Limitation at buy-back—if the whole of the scheme has to be bought back, the whole point of this limitation is to see that the cost of this is not too high—requires that the upper limit, which I have described, be discounted from pension age to the time of buy-back in order that it may be compared with the GMP accrued to that time. The discounting is performed at the rate of increase of earnings used by the Government Actuary in the calculation of the buy-back terms so that, if limitation does occur, the product of limited GMP and the cost per unit is independent of that rate of increase.

It is interesting that if this rate—the rate of increase of earnings assumed in the buy-back terms—is very large, limitation will occur but will have no effect on the total cost, as I have just said. If, however, the rate of increase of expected earnings in the future is small enough, limitation will not occur but the buy-back cost is therefore small, because of the low escalation expected in future. Hence there is no need to use any but one future estimate of earnings increase in the buy-back terms. In this I disagree with Mr. Lyburn who suggested a more complicated basis aimed at counteracting the possible ill effects of changes in anticipated rates of inflation. But the limitation method I have been discussing protects against both actual and anticipated inflation.

I put this method forward for two reasons. Firstly, I know that there is a serious problem requiring solution, and I think I can say that any actuary who has looked into the problem knows also that there is a problem requiring solution. Secondly, I have tested my solution and found that, in my opinion, it accords as closely as possible with the principles of “Better Pensions”; it can easily be administered both by the D.H.S.S. and by those who run private schemes, in fact, it is defined in enough detail to be incorporated in the Pensions Bill; it allows the actuary to produce reasonable funding rates, and, most important, it provides the necessary safety net for employers who wish to contract out. So—there is a real problem, but there is a practical solution. That being so, I sincerely hope that there will be a corresponding amendment in the Bill.

* Precise statement of limited GMP (LGMP)*

The following defines the LGMP arising from a number of years of contracted-out service the first of which is $y_0$ and the last of which is $y_1$. Since the value of GMP depends on the year in which it is calculated the symbol

\[ \text{LGMP}_y \]

is used to denote “the value of LGMP calculated in year $y$”. $y$ is taken as being no earlier than $y_1$.

**Definition**

(i) \[ \text{LGMP}_y = \min \{\text{GMP}_y; P_y (\max \{\text{LMP}; S\})\} \]

where \( \min \{A; B\} \) means the smaller of $A$ and $B$

\[ \max \{A; B\} \] means the larger of $A$ and $B$. 

(ii) \( \text{GMP}_y = \text{NAE}_y \cdot \frac{y_1}{x+y_0} \sum_{x=y_0}^{y_1} (E_x \div \text{NAE}_x). \)

where \( \text{NAE}_x = \text{National Average Earnings for year } x \)
\( E_x = \text{Contracted-out earnings in year } x \) in the upper band (roughly between \( \frac{1}{4} \text{NAE}_x \) and \( 1\frac{3}{4} \text{NAE}_x \))
\( r = \text{Accrual rate for GMP (between } \frac{1}{196} \text{ and } \frac{1}{80}. \)
(GMP is thus as defined in the Pensions Bill.)

(iii) \( \text{LMP} = r \cdot \sum_{x=y_0}^{y_1} E_x (1+f_x)^{y_r-x}. \)

where \( y_r \) is the last year of revaluation before pension age, and \( f_x \) is the fixed annual rate of increase applying to earnings in year \( x. \)
(LMP would thus be equal to GMP\(_{yr}\) if each \( \text{NAE}_x \) increased at \( f_x \) p.a.)

(iv) \( S = \text{GMP}_{yr}/80r. \)
(S is thus the minimum requisite pension in a contracted-out scheme based on eightieths of revalued average earnings. Revaluation ceases at the date of cessation of contracting-out if this is before normal retirement date.)

(v) \( P_y \) is the proportion that GMP\(_y\) bears to the anticipated GMP at pension age.
(The anticipated GMP depends on the expected rate of increase used in the calculation of the State scheme premium used in buy back.)
In particular, \( P_{yr} = 1. \)

Particular Cases

It is useful to see what LGMP\(_y\) becomes in particular cases.

(1) LGMP\(_{yr}\)

LGMP\(_{yr}\) is the value of limited GMP at pension age.

(a) If the member retired from contracted-out active service in year \( yr \) then \( y_1 \), the last year of the period of contracted-out service giving rise to LGMP\(_{yr}\), is \( yr. \)

Hence \( P_y = P_{yr} = 1. \)

Also \( S = \text{GMP}_{yr}/80r \) and so

\( S \) is not less than \( \text{GMP}_{yr} \) since \( r \) is not greater than \( 1/80. \) Thus

\( \text{LGMP}_{yr} = \min \{ [\text{GMP}_{yr}; \max \{ \text{LMP}; S \}] \}. \)

Since \( S \) is not less than \( \text{GMP}_{yr} \) then \( \text{LGMP}_{yr} = \text{GMP}_{yr}. \)
There is no limitation in this case.

(b) If a frozen pension falls to be paid at pension age we have \( y_1 \) less than \( yr \) although we still have \( P_y = P_{yr} = 1. \)

In this case \( S = (\text{GMP}_{yr} \times \text{NAE}_{y_1}/\text{NAE}_{yr})/80r. \)
If \( \text{NAE} \) has increased sufficiently quickly between \( y_1 \) and \( yr, \) \( S \) will be less than \( \text{GMP}_{yr}. \) If, in addition, \( \text{LMP} \) is less than \( \text{GMP}_{yr}, \) then limitation will occur. But it will in no circumstance result in \( \text{LGMP}_{yr} \) being less than \( S, \) which is the scale frozen pension arising in year \( y_1. \)

(2) LGMP\(_{y_1}\)

Where \( y_1 \) is less than \( yr \) then the calculation of minimum pension is performed for buy-back, either because the employer wishes actually
to buy back the LGMP or because it is required to test that the assets are sufficient to cover the minimum benefits.

In this case we have, as before,
\[ S = \frac{\text{GMP} y_{1}}{80r} \geq \text{GMP} y_{1}. \]

However, in this case we have \( P_{y_{1}} < 1. \)

If \( P_{y_{1}} \) is small enough, either because the expected increase of GMP is large or because \( y_{1} \) is a long period of time away from \( y_{r} \), then \( P_{y_{1}} \cdot S \) will be smaller than \( \text{GMP} y_{1} \). In this case, as in (1)(b), limitation could occur.

Mr. C. W. F. Low:—The timing of the presentation of tonight's paper is on the one hand fortuitous and on the other most unfortunate. It is fortuitous because of the opportunity to have a discussion on the Social Security Pensions Bill 1975 so soon after its publication: it is unfortunate in that the authors, as the title of the paper would suggest, have covered a very large field indeed and raised fundamental questions the decisions from which have far-reaching economic effect on the entire way of life of our nation for generations to come. Whilst I acknowledge that we should discuss in this Hall the relative merits of a funded or pay-as-you-go State scheme, or the suitability of a higher level in real terms of non-wage-related State pension as the only State pension provision, I would urge that we accept the political reality of the current situation, namely that the Social Security Pensions Bill will be enacted with only the possibility of very minor amendments, and that all the efforts of our profession and of the pensions industry be concentrated on making the proposals in that Bill work. It is surely correct for Government, which is, as the authors state in paragraph 2.16, "the charity of last resort" through social security supplementary benefit, to intervene on grounds of social justice to protect the individual from himself. We have known the worth of occupational pension schemes and have been actively selling them to employers and employees for forty years or so. Government action is clearly needed to force on employers and employees alike the need to make provision for retirement where they have not responded to our sales efforts. The main concern must be that such action is restricted so as to promote the growth of retirement provision, be it State or occupational, where before there was none, and not to inhibit the good occupational schemes that already exist.

What is crucial, therefore, is the contracting-out terms and the wider view beyond the valuation of the current terms to the element of trust in the continuing fairness of future terms, as well as the increasingly heavy administrative burden of satisfying contracted-out minima, Inland Revenue maxima and O.P.B. solvency tests. The contracting-out rebate will fall as the average accrual rate of the State scheme falls, from 1/80ths to 1/160ths, so that it will always cost more to provide a contracted-out scheme than to participate in the State scheme. This additional hurdle for the occupational pensions industry to surmount is at its lowest now.

The terms are, of course, tight. At this stage they cannot be fully quantified as we have not yet seen the actuarial tables to be prescribed by the Secretary of State under Clause 41(3) of the Bill, but I estimate that if the Government Actuary were to advise tables based on a long-term rise in the cost of living of 8% and allowing for a long-term yield of 9%, the funding rate for an average age distribution for minimum contracting-out benefits would approach 10% of salaries, i.e. 3% more than the contracting-out rebate. The benefits in return for this extra contribution are reaped by the younger employees, those aged under 45, and this is the group which will form the
most pressure on employers, possibly via the trade unions, to have an
occupational scheme. I, for one, am glad that the minimum requirements
have been set as high as they are, as, in the corresponding discussion on
the Social Security Bill 1972 which the Faculty held two years ago, I
criticised the State Reserve Scheme and proposed recognition tests as being
at far too low a level, and suggested that they be at least doubled. Now
that the minimum is at a more realistic level, I fully support the authors' call in paragraph 2.7 for the Inland Revenue to allow realistic maxima.
There is ample justification for restriction of tax-free lump sum benefits,
both on death in service and on retirement, but with these two exceptions
I can see no logic in any restriction at all. The market force of price is
surely sufficient. If, however, restrictions are to continue (and I fear that
they will) then I hope that the Revenue will at least improve the two-thirds
after ten years limit to, say, three-quarters and resist any temptation to
have a combined limit. Any combined State and occupational limit would
surely be administratively impossible in respect of increases in pensions
in the course of payment. The State is forcing the pace of cost-of-living
increases on the total State pension and on the GMP of a contracted-out
scheme. Whilst the occupational scheme cannot hope to match this when
it does not have the open-ended income of pay-as-you-go contributions,
pressures must surely come from members for some increases in the balance
of their pension. The larger the balance of the pension, the greater the
pressure. Is an employer going to grant 5% increases on the pension in
excess of GMP or 3\% increases on the total pension? Even if he restricts
his increases to the balance over GMP, the only figure of which he will be
advised by the State, there will still be some overlap of increase on part
of a State pension, because the second-tier State pension will exceed GMP
by taking into account the best twenty years formula. Any attempt by
the Inland Revenue to eliminate this element of over-escalation would
quickly lead to no escalation at all being provided by occupational schemes.
Surely this is not what the Government wants.

The solvency tests to be administered by the O.P.B. under Section 38
of the Bill are only to be expected when contracting-out is allowed.
However, great flexibility must be allowed in times of exceptional financial
conditions, e.g. the present, with very high salary inflation and restricted
dividend and rental income on investments leading to negative real yields,
if occupational schemes are to exist without severely threatening an
employer's solvency. If the current exceptional conditions persist for any
length of time, there can be no future for funded occupational schemes or
any long-term savings media until Government supplies an index-linked
investment or moderates, if not cures, inflation. Inflation has led to only
final salary benefits being acceptable for the State scheme, and final salary
or revalued average for contracted-out schemes. It also in time makes
any funded scheme insolvent, leaving pay-as-you-go as the only funding
method. Thus, if Government wants partnership with occupational
schemes to provide secure funded protection for retirement, the first
essential is not O.P.B. solvency tests but a return to normal investment
conditions which allow a real positive yield to be earned.

Mr. C. S. S. Lyon:—About seven years ago I also, with induced sponta-
neity, wrote a paper on this subject for discussion in this Hall and I therefore
very much welcome the public spiritedness of our two authors tonight.
As one who, in the immediately pre-Crossman days when the paper was
presented, was very much in favour of the abatement concept which had
been invented not so long before by Frank Redington, I feel that the
type of abatement included in "Better Pensions" and in the Bill is, in principle, superior to the version in the Crossman Scheme. That was an artificial abatement of £x per annum pension accrual whereas the abatement in this Bill is intended to be of the entire second-tier pension.

However, I would like to say one or two things about the present situation which I believe cannot be emphasised too strongly. The first is that we as a profession have a proud record of achievement in fostering the development of funded occupational schemes. In so doing we have provided security for pension rights. This is absolutely essential when one is dealing with mortal employers, if I can call them that. We have been charging the right generation of employees the cost and, more important perhaps, the right generation of shareholders. The result has been a high contribution to net personal savings, but I think we have to recognise that funding in this way is a means to an end and not an end in itself. The object, as the authors have said on the first page of their paper, is to provide pensions for people. Pensions are increasingly becoming the subject of collective bargaining and are ceasing to be a paternalistic reward for long service. So it is natural for the State to take an interest because there are those whom it is difficult to cover effectively and economically in occupational schemes. I do not think we can criticise the State for doing that, nor am I sure we can criticise the State for seeking to build a future without bringing up the levels of existing pensions to the eventual level which tomorrow's pensioners will have. After all, when we sell a scheme to an employer we may put in a pension of two-thirds of final salary for the future, but we do not bring up to that level all the existing pensioners the employer may have, still less employees who have retired without any pension.

A further point is that funding only offers security in pounds, not in real money. Those who used to think that equities and property would produce security in real money have been sadly disillusioned recently. The fact is that the next generation has to service the funds. If it does not want to, it can reduce their real value along with the real value of other savings simply by creating a negative rate of return. This leads to deficiency payments, which are simply a way of making the employer pay again the contributions that he paid in the past and thought sufficient to meet the pension accrual. That, I submit, is inflationary in itself because it is likely to be passed on to the consumer in the form of price increases.

Now, I firmly believe that a contracted-out partnership is important. It equalises the contribution burden between different generations because it is a form of partial funding of the State pension, but its success depends on an end to the situation I have just been describing. Once employers feel that the right way of looking at the contracting-out terms is as a means of laying off some of their inflation risk by insuring benefits with the State scheme at a contribution of 7%, instead of the other way round, the writing will be on the wall. People want pensions. If inflation becomes such that funded schemes cannot provide them or can only do so by reinforcing the inflationary pressures, we shall have to adopt a different system, as the last speaker has said. Let the politicians and the C.B.I. and the T.U.C. take note of this. We as a profession will play our part for so long as it is credible; the politicians' actions will decide how long this will be. Mr. President, it is as simple as that.

Mr. R. E. Macdonald:—This paper and the introduction of yet another proposed earnings-related State scheme provide once again the opportunity to review and examine the shibboleths—I do not think there is any better
word to describe the discredited tests for approval which pension schemes have to undergo. The authors make the customary appeal to common sense in the early pages of their paper and, although it has been convincingly supported by practically every previous speaker, one has the sinking feeling that the administration is impervious to appeals to common sense. Ever since the establishment of a separate limit for the approval of lump-sum retirement benefits, innumerable appeals have been made for the removal of the pension controls which at once became superfluous. One gets the impression that in the halls of the Inland Revenue the two-thirds rule, the sixtieths rule, have the status of Holy Writ. To criticise them is blasphemy but in these permissive days the blasphemer is no longer burned at the stake—he is merely ignored.

When we come to consider the form of the State pension, the manner of its financing and the extent to which the private sector should be used to provide it, Mr. O'Malley has already said tonight that it is probably past the time for discussion of these matters and we have to accept that these are not matters which will be decided by a vote of technically qualified representatives of the pensions industry. Whether we like it or not they will be decided by politicians and they will make the decisions on political grounds. Unless the technicians can prove that disaster will ensue, they would do well to hold their peace and try to tidy up some of the practical details.

For example, we have just escaped by the skin of our teeth a State fully funded scheme about which most of us must have had serious reservations, but we certainly did not escape it because of technical arguments. We are now about to undergo yet another run-up to a pay-as-you-go earnings-related scheme. We can, if we wish, produce strong arguments for the ideas of paragraph 2.26 but these are not technical arguments at all and the authors' suggestion of potential disaster in paragraph 2.25 seems to me to be highly exaggerated. I am realistic enough to accept that a politician gets his votes from this generation and not from future generations, and even if future generations modify this generation's pensions there would at least be a rough justice in that. After all it is this generation which, by allowing inflation to run riot, has wrecked the savings and the standard of living of our retired fathers.

Another feature of the proposed new State scheme which we would do well to accept thankfully is the apparent political acceptance of the idea that the private sector should be allowed to provide, if it can, the earnings-related portion of the State pension. I am disturbed by the tendency in certain quarters at present to look this gift horse in the mouth and to suggest that at present rates of inflation employers cannot be asked to provide final salary pensions privately. It has been our misfortune in this country to have suffered a succession of Governments, none of which have been prepared to stamp out inflation and some of which have even believed the unfortunate side-effects of reducing inflation to be less acceptable than inflation itself. But there is no need for us to provide the Government with further incentives to do nothing. The more that pensioners can be made to suffer for the benefit of the active population the less incentive there is to a Government to apply a cure for the disease. We should therefore be persuading all employers that they have a public duty to immunise present and future pensioners against inflation, and that the prices of the employer's products must be adjusted to ensure that the present generation pays for that.

What is more, in order to remove the uninsurable risks to which Mr. O'Malley made reference we ought to be pressing the Government to
make index-linked investments available to all pension funds. I suggest the restriction to pension funds because only a Government determined to eliminate inflation completely would propose to issue index-linked investments universally. As it is, the Government proposes, for contracted-out members, to accept the index-linked liability on vested pensions and also a proportion of the earnings-related liability for preserved pensions. The authors of this paper point out the enormous complications arising from this to-ing and fro-ing of liabilities. They do not point out that the whole process would be enormously simplified by giving the pension funds index-linked investments to employ as they please for the purpose. Fund investment managers with some regard for history will take up some of these investments as a hedge but will bear in mind that up to 1973 they could certainly have done better on an income basis, and probably on a capital basis, with equities and property, and if our economy is to survive in roughly its present form they will do so again.

I do not therefore subscribe to the view that a partnership with the State is impractical, although I believe that index-linked investments would provide a more realistic base for it and it may be that the contracting-out terms are wrong; if so they can be changed. I do not like the role of the private sector as sketched out with forebodings of gloom in paragraph 4.16. The private pensions sector has always played an important part in pensions provision in Britain, I see every reason why it should continue to do so, and I am delighted to hear that Mr. O'Malley thinks so too.

Mr. D. B. Smee:—Firstly I would like to thank you for inviting me to attend this meeting as the President of the Society of Pension Consultants. As you can hear, I am what I think you call a Sassenach and I admit that I am a layman. In fact, I think that I am the first layman to have the pleasure of addressing you this evening. Some weeks ago, namely the 27th of February, when our chairman Sir Ronald Sargent and I were waiting for the Social Security Pensions Bill to be released, I turned to Sir Donald and said that at that moment of time I felt very much as I felt when my last child was born. Before very long, midwife Barbara produced the child and it was not quite such an ugly duckling as we had expected. In fact, we thought that it could turn into quite a presentable swan. However, I must say that in my capacity of talking to you tonight our Society has not had an opportunity of joining together for a full discussion, and therefore I cannot say and speak on their behalf; I can only give you my personal views.

I would like to pay tribute to Mr. O'Malley because in May of last year, having suffered, as the authors of this paper have indicated, from so many frustrations, I have warmed to the Minister's approach to the problem of combining the State with occupational schemes and I feel that there is substance in the Bill that will enable us to go forward within this concept.

During the course of his talk this afternoon, Mr. O'Malley mentioned the possible starting date of 1977, and I know very well that within the actuarial profession that is not a particularly acceptable date. However, may I make these points: firstly, when Sir Keith Joseph's Bill was enacted we had about the same time to implement those provisions that we are now to be given, if the starting date is April 1977. I think that it would be churlish for us to deny one Administration what we accepted from an earlier one. However, this must be subject to the following: Firstly, while I would accept the early implementation of the Act, it has to be more or less in its present form; secondly, the regulations from the Department
and O.P.B. must be quick and simple to understand, and thirdly, it must exclude the three remits to the O.P.B.

However, there is no point in talking about the implementation of the Bill unless the Government can give proper protection to savings against inflation.

The second point I want to make concerns the subject that has exercised our minds for many months past, namely the question of preservation. Like most of us in this Hall, I welcomed very much the move in the right direction when we saw, within the Bill, that there was at least a limitation of 5% plus a capital sum, but I am concerned about the capital sum because it introduces a feature of uncertainty which is bound to upset the "sales" approach to an employer. I would hope that consideration can be given to an alternative method, one of the methods perhaps that was discussed by Mr. Gwilt this afternoon, which would enable us to go forward to the employers with a more positive proposal.

The last point I wish to make concerns the rebate. We have to acknowledge with satisfaction the increase from 6½% to 7%, but Mr. Fraser Low told us that in his view a figure of 10% was more likely to be the going rate for the normal type of scheme. If that is so, the difference of 3% is too big, and there must be activity within the industry to encourage the Minister to give further consideration to this aspect.

In conclusion, within the pension industry there is much concern arising from the requirement to provide inflation proofing to graduated pension. This regrettably is a case of changing the rules after the game has been played. We are going to be faced with many difficulties. These may be academic, or they may be emotional; but nevertheless they are going to be there because many employees will be asking employers to restore what they will genuinely consider to be a loss in benefit arising from the Company's decision to contract out.

Thank you for inviting me to attend your meeting and giving me the opportunity to address you.

Mr. A. G. Young:—The authors have put forward two strong arguments for an employer to reject contracting out, namely cost and administration. I should like to say a few words about each of these.

Over the years, changes in legislation relating to occupational schemes have generally led to an improvement in schemes, either by a reduction in the cost or by an increase in the benefits. Members of schemes have benefited from either or both of these. A change from the old code to new code is an example of such an improvement.

Accepting that the Social Security Pensions Bill does follow this element of improvement, as it clearly does in relation to the existing State pension, does the spirit of the Bill extend also to the terms of contracting out?

The answer obviously depends on how favourable these terms are. Grave doubts have been expressed about the ability of employers to meet, in all circumstances, an indeterminate State scheme premium to replace an unknown liability.

Could not the terms for contracting out be made more acceptable? I think they could, by raising the 5% level by which the guaranteed minimum pension must be increased and, as a quid pro quo, dispensing with the State scheme premium otherwise required to meet the unknown liability above the new level. An employer could then fund definitely for the preserved pension, either for leavers, or for all members, if the scheme is discontinued.

Turning now to the second of the authors' arguments for an employer
to reject contracting out, namely administration. Legislation over the years has led also to some improvement in administration, although, as the authors have pointed out, the rules governing approval of occupational schemes by the Inland Revenue are complex. One example of the easing of administration is the allowance of a cash sum at retirement under a Section 222 Fund, since cash can now be provided under one plan instead of, for instance, under separate deferred annuity and endowment assurance schemes.

If the terms for contracting out are not made sufficiently attractive, what are the alternatives open to an employer who has a scheme already in force? He would have to contract in his scheme and consider the following alternatives.

(a) Continue the same scale of pension; or
(b) Reduce the scale of pension to make some allowance for the State scheme earnings-related pension, but not adjust the scale on every occasion when the State scheme earnings-related scale is amended; or
(c) Reduce the scale of pension to allow for the State scheme earnings-related pension and adjust the occupational scheme pension every time there is an adjustment to the State scheme earnings-related pension—i.e. fully integrate his scheme pension with the State scheme earnings-related pension.

As an ultimate measure, he may decide to discontinue the scheme. This decision, or (a), is likely only if the scale of pension is small. Where the scheme is already providing a high pension, (b) or (c) is more likely, but each could result in an increase in the administration of the scheme.

And so, the terms in the Bill for contracting out not only make contracting out itself unfavourable but also, because of the administrative tangle of integrating the occupational scheme pension with the State scheme pension, make contracting in unfavourable for the many employers who already have schemes providing generous pension.

Surely by making the contracting-out terms more acceptable, the time, effort and money saved in avoiding this extra administration would make it well worth while. It would encourage an employer, who already has a scheme providing a small pension and who might otherwise stop his scheme and contract in, to provide pension beyond the minimum pension level and contract out. Also, it would encourage an employer who has no scheme to start a contracted-out scheme which hopefully, in the course of time, he can develop into one providing pension much in excess of the State pension. Would this not present a more practical partnership between State and occupational schemes?

Mr. T. Young, closing the discussion, said:—The paper by Messrs. Low and Felton deals with both State and occupational pension schemes and particular reference is made to the White Paper “Better Pensions”. The Social Security Pensions Bill derived from the White Paper has now been published and the authors’ remarks have, to some extent, been overtaken by events. But their paper has provided an opportunity for individuals to give their views on the Bill, and in that respect their timing could not have been bettered.

Among the distinguished guests present tonight we have Mr. O’Malley, Minister of State at the Department of Health and Social Security, and I trust he will appreciate that it has always been the intention of our profession to be constructive rather than destructive on the question of State pensions.
No-one knows better than those directly involved in pensions (and this point was made by both Mr. Gwilt and Mr. Cairns) the waste of resources and skilled manpower in the past years as we tried to grapple with the schemes proposed, but never implemented, by the two major political parties.

Before coming to the Bill, may I join Messrs. Cairns, Gillon, Lyburn, Low and Macdonald in wholeheartedly supporting the authors in the section of the paper where they criticise the present approval of pensions schemes procedures. The delays encountered in dealing with both the Superannuation Funds Office and the Occupational Pensions Board have reached dimensions of truly comic, or perhaps I should say tragic, dimensions. The authors have rightly emphasised the futility of the constraints on levels of benefits and Mr. Lyburn in his opening remarks has pointed out the needless waste of resources in both public and private sectors. Here indeed a very significant saving could be achieved "at a stroke".

The authors, with commendable altruism have rejected contracting-out on the grounds of administration and cost. But they themselves in their remarks have provided the real case for contracting-out.

In theory, a pay-as-you-go system is perfectly satisfactory in the context of a State scheme or any scheme where the costs of benefits can be charged against an impotent public. It is not satisfactory in the context of a private scheme where the security of the benefits lies in the ability of the employer to pay. In practice, since people do not pay for their own pensions under a pay-as-you-go system, there is an irresistible temptation to award oneself a generous benefit in the knowledge that others, viz. a future generation, will have to meet the cost. There is, however, no guarantee that the future generation will tolerate that cost. The only real control is to ensure as far as is practicable that people pay for their own pensions—and that is exactly what funding does. Funding, apart from building up the security of benefits, exercises a control or discipline over the self-award of excessive benefits, and Mr. Lyburn summed up the dangers of pay-as-you-go very neatly when he said that pensioners can ultimately receive only what the working population is prepared to give them.

Contracted-out schemes must be properly funded and therefore the more contracting-out there is, the more the State scheme is effectively funded. It follows that if the Government wishes to avoid future generations welching on imposed commitments—in short, if it wishes to ensure the viability of its own scheme—it should encourage contracting-out, and it must set the terms and conditions such that they provide real encouragement. Neutrality is not good enough. Funding, of course, also produces real saving and is thus anti-inflationary.

Having said that—are the terms reasonable?

There are three elements which are crucial in providing an answer to this question.

The first, touched on by both Mr. Cairns and Mr. Low, is the requirement that in order to qualify for contracting-out purposes a scheme must provide 80ths of final (or revalued average) earnings. It can be argued that a scheme providing less than 80ths cannot be regarded as satisfactory. Nevertheless, the fact remains that in the extreme position the contracted-out benefit is more than twice the State benefit which it replaces. The existence of such a gap poses a problem for the employer who is willing to provide benefits better than the State scheme but who is as yet unable to meet the 80ths requirement. The enforced contracting-in may kill the possibility of benefits ever reaching even the contracting-out level, since once an employer has contracted in he may well be reluctant to add further benefits to his scheme.
The second element is the reduction in State contributions allowed where the employer contracts out, and Messrs Low, Smee and Cairns referred to this point. The Bill sets a total of 7%, but hopefully this is negotiable. In its simplest terms the question is whether 7% is reasonable as a cost of the benefits foregone in the State scheme. I am sure there is a consensus view that 7% is too low and does not provide a real incentive to contract out. The authors claim, and are supported by Mr. Lyburn, that the original 6½% was too low, and by the same token this is true of 7%. To provide encouragement we need something more than the neutral equivalent, and the neutral equivalent is more than 7%.

The third and potentially the most damaging element is the enforced pre-award revaluation of the guaranteed minimum pension in line with earnings, and this has been referred to by Messrs. Low, Smee and Young. One can understand how this idea arose and it fits well into a State or public service scheme. One cannot understand how anyone ever thought it could work in the context of an occupational scheme where, for example, an employee who leaves ceases to contribute resources from which the costs of his revaluation could be met.

There are signs that the impracticability of the original suggestion is becoming apparent in Government quarters.

One of these signs is that under the Bill the employer is allowed to buy out revaluation in respect of leavers in excess of 5% per annum. This has been allowed because the benefit was an open-ended commitment and therefore uninsurable. But the amended proposal does not eliminate the open-ended commitment, because the buying-out terms will be affected by inflation and therefore are themselves open-ended.

What the proposed amendment does is to enable the employer to determine his liability in respect of a leaver at the date of leaving—but what we really need is a system that will enable the absolute liability to be fixed, with some degree of confidence, at any point of time prior to leaving, so that proper funding arrangements for leavers can be made. The problem of leavers has been widely discussed and no-one can now claim to be unaware of the dangers, but leavers present only a particular aspect of the more general problem of the revaluation of guaranteed minimum pensions. If a general solution can be found, the problem of leavers will disappear.

A further problem in respect of the revaluation of guaranteed minimum pensions is the effect on the in-force members of a scheme. That this problem has taken a little time to emerge is understandable since it was assumed that an 80ths scheme would always be able to clear the guaranteed minimum pension level for those who remain in a scheme and hence attention was focused on those who leave. It is, of course, quite reasonable to assume a positive margin of benefit in favour of the contracted-out scheme benefits over the guaranteed minimum, since such a margin would be vulnerable only to national average earnings rising faster than the earnings of the occupational scheme. The problem that arises is due, once again, to a failure to appreciate the fundamental difference between a State and an occupational scheme.

No employer can guarantee the future solvency of his scheme, and circumstances can and do arise when he can no longer carry on (and this point was referred to by Messrs. Cairns, Gwilt and Low). He terminates his scheme and the available assets are distributed equitably in terms of the rules.

Or, a deficiency can arise which an employer can deal with over a period of time without in any way affecting the viability of his scheme. Thus a
well-meaning employer can set up a scheme for his employees without, in any way, guaranteeing either its solvency or its continuity. But what is the effect of the guaranteed minimum pension requirement if the O.P.B. insist that the assets must always be sufficient to cover the total buying-back price? The buy-back price is related not to current earnings but to prospective final earnings. If the assets do not cover the buy-back liability, is the scheme to contract back in and must the employer immediately make good the deficiency? If so, then the employer could be bankrupted—arguably by his own generosity; or a viable scheme could be destroyed—by such a technical inflexibility.

Two possible sources of a buy-back deficiency spring to mind, and they have been referred to by Mr. Gwilt and Mr. Cairns: a large fall in the value of investments and a large rise in earnings, and 1974 provided a very good example of both events.

A possible amelioration of the problem of a fall in investment values, provided it is accompanied by a corresponding rise in the return on investments, has been suggested by Mr. Gwilt and Mr. Lyburn in the linking of the rate of interest on the buy-back terms to current investment returns.

The problem of large increases in earnings presents more difficulties and various possibilities have been suggested—one suggestion is so to arrange matters that the employer can buy back before a large increase in earnings affects the buy-back terms. Another suggestion consists of limiting the revaluation of the guaranteed minimum pension. This latter suggestion, eloquently advocated by Mr. Gwilt, would appear the more rational approach, since any solution which retains the open-ended commitment, in whatever form, will not be satisfactory. Whatever the final solution is, it must enable the employer to overcome temporary deficiencies since, given time, each individual employee's benefit should exceed the guaranteed minimum requirement. In addition, the solution must enable an employer to cease contracting-out without the possibility, however remote, of incurring a crippling cost. It cannot be too strongly emphasised that these problems are not the creation of employers, or the pensions industry, but are created by forces outwith their control, principally inflation—and only the Government can do anything about inflation.

I have attempted to highlight what I see as the major problems referred to by the speakers tonight; I have not attempted to offer solutions although several have been offered tonight and I think they are worthy of further study. The matter of vital importance is for the Government to grasp the nature of the problems. Without this understanding the outlook is indeed pessimistic.

But, if these problems can be solved, then we can have both a viable State scheme and a viable pensions industry. We cannot have one without the other, and I hope that, in the future, we can look back on tonight and be grateful for the opportunity to comment on the Bill.

It only remains for me to thank the authors for their timely and valiant efforts to bring a little sanity into an area for too long bedevilled by politics.

Mr. P. E. Felton, replying to the discussion, said:—You will no doubt be delighted to know that I do not intend to talk for very long at all. I should just like to pick out two particular speakers to whom I was particularly grateful. The first was Mr. O'Malley because he promoted me at a stroke to the status of Fellow of the Faculty of Actuaries. He also gave us the current cost of the Low/Felton State pension scheme and it was interesting to note that was less than we are committing future
generations to pay for our pensions 20, 30 and 40 years hence. The second speaker was Mr. Gilson, who apart from saying many things which I thought were very sensible, also raised the subject of the Calcutta Cup which natural modesty would have prohibited me from doing myself.

I think it has been a most interesting and I hope rewarding discussion, and on behalf of Alistair Low and myself I would like to thank everyone who took part and the Faculty for inviting us here. Thank you very much.

The President (Mr. J. G. Wallace):—I think you will all agree that tonight's paper has been the basis for an excellent exchange of views, and I hope to arrange for Mr. O'Malley and Mr. Fowler to have a summary of the discussion.

May I ask you all to join with me in giving the two authors a very hearty vote of thanks for their efforts in producing this paper.

Mr. T. W. N. McCallum wrote:—Like Mr. Lyburn, I hope that all politicians, and particularly those concerned with the new Social Security Bill, will take the trouble to read tonight's paper carefully and intelligently, and that they will appreciate that the comments are professional and unbiased.

Much of the training of an actuary concentrates on the ability to look into the future. On the other hand, he is not supplied with a crystal ball, and I wonder how many of the problems which may affect schemes contracted out of the new State Plan would have occurred to us had the new Plan been introduced 10 years ago. I venture to suggest that not one of us would have predicted a rate of inflation rising above 10% let alone reaching 20%. For myself, I thought that such inflation could only occur in South America! Also, I doubt if we would have foreseen the massive taxation of employers, the limitation of dividends, the present economic position of the country, and the resultant collapse of the investment market. However, it has now been demonstrated that these things can happen in Britain and, as a result, actuaries concerned with the operation of occupational schemes are sadder and wiser men.

I think it is essential to stress two very simple points relating to contracting out.

The first is that the main objections to the contracting-out provisions of the Bill would largely disappear if the present Government and successive Governments will undertake to ensure that annual inflation will never exceed 5% per annum. Or alternatively, if that is asking for the impossible, that the investment market is allowed to operate freely, in which case there is a possibility that pension funds could hope to earn interest at least equal to the rate of wage inflation.

The second is that I have the impression that the present Government takes the view that, because employers have been able to finance final salary schemes in the past without too much difficulty, the alternative standards for schemes contracting out of the new State scheme should be quite acceptable. At the risk of repetition, may I spell out in simple terms the reasons why this assumption is so wrong.

(1) From 6th April onwards, the employer has to meet the additional cost of compulsory preservation and, from 1978, preserved benefits will have to be revalued, or bought back, at an unknown rate.

(2) The level of pay for female employees is in course of being brought into line with males. Their scheme benefits will increase accordingly and will cost even more because they are to be encouraged to retire 5 years earlier than the opposite sex.
(3) Very few employers can be expected to find the funds necessary to provide retirement benefits for active employees which multiply retrospectively with rampant inflation of wages.

(4) When a scheme is voluntary and an employer finds that inflation has put his target pensions beyond his means, he can reduce the benefits, or in the ultimate, wind up his scheme without further expense. After 1978, the standards for a contracted-out scheme are such that even one year of excessive inflation could readily lead to near bankruptcy.

The answer seems to be quite clear. Any British Government must accept responsibility for controlling inflation and ensuring that this country lives within its means. If it doesn’t, and if the Government sincerely wishes to foster occupational schemes, then an employer must be protected against the effects of high inflation by a statutory limitation of his liabilities under a contracted-out scheme.

Mr. T. G. Arthur wrote:—I would like to congratulate the authors on an excellent and analytic paper, sorely needed at the present time, which should do much to sort out the confusion running rife in Government and pension circles. If only we could be confident that some of their suggestions would be heeded!—although I beg leave to differ on the question of abatement where the authors’ conclusion seems to hinge on a fallacious assumption that “the good of the country” is served if, and only if, real saving is created.

However, there is one area in which I would like to dream of future justice as opposed to current injustice to an even greater extent than the authors; I refer to their argument that the State should provide a universal flat rate pension, set out in paragraphs 2.16 and 2.17, which the authors manage to resolve rather too quickly for comfort, in my view.

Paragraph 2.16 establishes that the State rather than private charity must pay benefits to a few unfortunates, in a manner which is not convincing to me, but this is a relatively minor matter given the current levels of State intervention, and I would like to concentrate on the argument in paragraph 2.17 that State benefits for the very few means that they must also be extended to the many.

Three arguments are advanced in support of this, all to do with means-testing and even on their own terms (especially as they accept that two of them could be resolved) this is rather cursory treatment, because there are weighty arguments on the other side which are not brought into the reckoning.

In brief the main ones are:

Firstly, that a universal State pension, necessarily pay-as-you-go as the authors agree, forces us to depend upon the whims of future generations for our security in retirement. Contributions are taxes, as we all know, and the only “right” they confer is a begging bowl with which we can approach future workers.

Secondly, no man can plan sensibly for retirement, because the State will never have a stable system, as has been seen over the past 40 years, when retrospective changes have been made continually.

Thirdly, thrift, responsibility and personal saving are all devalued.

Fourthly, the system entails massive subsidies, often from the poor to the rich due to age, sex, working career, and so on.

Fifthly, both logic and the past 80 years’ experience suggest that workers cannot be forced to give up their consumption, so that pensioners are not helped at all. Wage demands and influencing expenditure patterns ensure that little real transfer is made, and this is why the authors’ suggestion that
the flat figure should be increased to take people off supplementary benefits is doomed to failure. Furthermore, it is impossible to get round the problem by promising benefits in real terms because whatever index is used to measure real progress will become distorted, as the retail price index has already become. For example, in the last 10 years real standards, according to earnings increases adjusted by the price index, have gone up by 23%, whereas real standards, according to real G.N.P. per head, have gone up by 17%.

Sixthly, total Government expenditure is now of crisis proportions and can only be made more critical by spending an extra £1,000 millions increasing the State pension.

Lastly, and perhaps most important of all, a universal system, whether limited to flat rate benefits or otherwise, is a grotesque infringement of the individual liberty of every person in the land.

What can the authors set against this? Three arguments about means-testing, depending upon an old-fashioned idea of a means test rather than a highly simplified tax form, and two of which they admit would be dealt with by a negative income tax. In fact no such revolutionary proposal is required to deal with these two arguments—a simple tax form and the sending of a cheque or postal order, or the direct crediting of an account, is all that is required. And if this still is frowned upon, the clawback system can easily encompass the clawing back of 100% of the State pension. Furthermore, have the authors done any sums on the expenses involved? The current system costs £250 millions per annum to administer, and these are merely the expenses paid directly from the National Insurance Fund. This is 5% of the total benefits, and would be 100% of the means-tested benefits. (Most pensioners are far from poor and on average State benefits comprise only one-fifth of their income. And, incidentally, why should a worker on £30 per week pay taxes to support a pensioner on £100 per week?)

The third argument, effectively that of the “poverty trap” and “lack of incentive”, is the one that would be best solved by a negative income tax, but in any event this phenomenon is the least of the various evils and is not eliminated by universal benefits, it is merely shifted onto someone else.

This brings me to my last point, which is that the logic of paragraphs 2.16 and 2.17 is admirably preserved when we talk about earnings rather than pensions, and indeed both paragraphs could be written with that substitution. Universal benefits for all, of the order discussed, would mean income tax at over 90% which shows how the “poverty trap” is merely shifted.

If we really want a humane system, the State pension should be reduced, not increased, and it is a pity that an excellent paper which examines matters from first principles should skip over this extremely important point in a manner that can only be described as cavalier.

Mr. G. G. Bannerman wrote:—I was sorry that I was prevented from speaking by the length of the discussion—itself, a well-merited tribute to the authors and their subject.

I am worried by the current attitude of some of those concerned with pensions—that they are so pleased that some measure of agreement seems to have been reached between the political parties that they do not worry about the terms on which this “agreement” has been reached. While it must be a heart-breaking experience to try to explain pensions to those who do not want to understand, I think that we should be doing the
profession a bad service if we gave up on the grounds that any agreement is better than none.

The Minister in his speech said that the cost of increasing the basic level by a worthwhile amount was too great. This means that the prospect of supplementary benefits will be with us forever. So long as supplementary benefits are paid they are an additional cost which must be met, and to give supplementary benefits for those who do not come up to the minimum scale and earnings-related benefits at a higher level to the more fortunate must cost more than flat rate benefits at the supplementary scale level for everyone.

The Minister also made a point of the fact that one major insurance company was doing its quotations with a 2% difference between the yield and inflation assumptions, compared with the 1% assumed by the Government Actuary. The insurance company is almost certainly using these assumptions for schemes where benefits on leaving service do not qualify for cost-of-living increases and the schemes concerned can therefore expect a surplus from withdrawals. No such surplus is possible from the Government scheme. The Minister said that he understood the difference, but I feel that this cannot be so or the point would not have been raised in the first place, the two bases being so different. Indeed I feel that if he does understand the difference but continues to use the comparison, it is not misunderstanding that we must be worried about but outright dishonesty of the same sort as claims that it is necessary, for equity reasons, for women to be given a much more valuable pension benefit than is given to men under the State scheme for the same contribution.

I go along to a large extent with the idea that pensions should be regarded as a form of deferred pay. However, I believe that once the money has been set aside to provide for a man's pension any form of inflation proofing not specifically provided for at the time is not true deferred pay, but is an act of grace by the employer. This is especially so in the case of cost-of-living increases to pensioners and I believe that, whilst the cost of pensions associated with wage increases is a proper addition to the wage bill, the cost of granting increases to pensioners should be shown as a completely separate item in a company's accounts.

Mr. W. B. McBride wrote:—The point is strongly made by the authors in paragraph 2.21 that funding of schemes may not be associated with a genuine decrease in consumption, and may instead be a contributory factor to inflation. It is hard to disagree. To a considerable extent the community has brought this particular evil upon itself by making saving through an occupational scheme such a highly tax advantageous matter; an ironic state of affairs considering the negative nature of early pension legislation. I do wonder, however, to what extent tax concessions organised exclusively on an employee only basis (hinted at in 2.27) would have led to economically significant funding. The difficulty with such an approach lies in educating employees to take proper advantage of the facilities: and to assume that this difficulty should not be too great does not easily square with the suggestion in 2.19 that individuals who have not persuaded their employers to provide them with retirement benefits are in part themselves to blame. Enlightened self-interest is unarguably a worthy character attribute, but it can gain only limited ground in a community of diverse social order, and is further constrained by the interdependence between individuals characteristic of all high technology societies.

The relative merits of flat rate and earnings-related State pension benefits have been debated vigorously in recent years, and perhaps a referendum
on views presently held in the profession would be more than merely fashionable. The administrative simplicity of a flat rate benefit supported by direct taxation has great appeal, but the problem of finding the right level has always appeared to me to be intractable: one person's level of affluence is another's poverty. The social implications of such a system are also disturbing; if it is right for everyone to receive from the State a high flat rate income in retirement, is it not also right for there to be a similar minimum income at work? or perhaps even from birth? Such cossetting from cradle to grave would be difficult to reconcile with the authors' belief in individual responsibility. Is that belief not better supported by a scheme of State pensions which broadly pays out in proportion to what was paid in? I must confess I have changed my mind on this issue in the past, but if an actuarial vote were taken today I would be found among those who supported earnings-related State pensions.

However, as Mr. Macdonald said, the technical vote probably has no effect on the course of events. The political impetus towards an earnings-related State pension appears to be irresistible, and I think we should concentrate our efforts on persuading the Government to relax Revenue benefit rulings, and to improve abatement terms, rather than on recommending a fundamental change to their plans. On the abatement issue I strongly support Mr. C. W. F. Low: a generous scheme securely funded should not contract in solely on the grounds that funding at the GMP level costs more than the 7% rebate. The "upside risk" mentioned in 4.15 is already being run by final salary schemes, and it is surely worth something of a premium over the purely commercial cost to minimise the dangers of pay-as-you-go mentioned in 2.25. The risk of bankruptcy on failure of the S.38 tests in the Bill are a deterrent mainly to the setting up of schemes on a marginal benefit basis, and rightly so.

Mr. G. Waugh wrote:—No adviser is going to recommend contracting out unless he is satisfied that the terms are viable. As I presently understand them I would say that they are not. The present terms not only require the employer to guarantee a final salary pension but also to guarantee at any point in time to have available the resources to meet the buy-back payment for every member of his scheme. Both these guarantees involve future rates of inflation and in the absence of some form of inflation-proofed investment it is impossible to fund to meet these guarantees. Funding can of course be attempted on the basis of assumed rates of future inflation, but any such assumption can only be guesswork, which if proved wrong in practice leaves the employer saddled with the ultimate financial responsibility for the guarantees. This is clearly a risk which he just cannot be expected to accept. For the risks to be acceptable, the benefits to be guaranteed must be clearly defined in predictable terms. Future rates of inflation are clearly not predictable.

It may be argued that the employer who has established a final salary scheme is already accepting the inflation risk. This is indeed true, but the important difference is that he gives no cast-iron guarantee of benefits. He retains the right to terminate the scheme, and the benefits on termination are restricted to those which the available resources in the fund will provide.

Having made the point that the employer cannot guarantee benefits linked to future inflation it is perhaps pertinent to ask if the State can guarantee such benefits. All the evidence at present suggests that the answer could well be "No". I regard it as not without significance that,
while the present generation of workers is prepared to transfer goods and
services to pensioners represented by only a 16½% contribution plus the
Treasury supplement, it is being implicitly assumed that future generations
of workers will be prepared to accept a transfer of goods and services of a
very substantially higher amount. I would have some confidence in the
realism of this assumption if everyone, including existing pensioners, were
brought into full benefit immediately. In the context of a pay-as-you-go
system the only objection to doing so would be the unacceptably high
cost. When the proposed new scheme reaches full maturity everyone will
be in full benefit. Will the cost not then still be regarded as unacceptably
high?

Mr. K. G. Weir wrote:—As the authors of the paper so rightly say,
the prime factor in planning a future level for State and occupational
scheme benefits is what can be afforded. Those who have had experience
of putting proposals to employers for the installation or improvement
of an occupational scheme know only too well that this is the main issue
on which such proposals are agreed.

Perhaps, however, the authors should have indicated that a great deal
also depends on how much the able-bodied working population is prepared
to moderate its own demands on consumption in order to adequately
provide for pensioners, dependants and other less powerful members of
the community. I make this point because my own personal experience
since the State Graduated Scheme was introduced, in April 1961, suggests
that employers in the private sector would have been more prepared to
improve occupational provision for manual or blue-collar work people
during the last 13 years if a more moderate attitude had been taken by
such people to demands for immediate increases in wages.

If one accepts the validity of this view, then it would also seem right
to make the point that the financial viability of the present Government's
"Better Pensions" proposals, which compulsorily increase superannuation
provision for those who are inadequately covered at the moment, will
probably depend on the willingness on the part of the working population
to accept a smaller share of the "national cake". The authors of the
paper rather hint at this point when they obliquely question the assumption
made by the Government Actuary, in his calculations in connection with
the proposed new arrangements, that real incomes will increase in future
at the rate of 3% per annum.

Perhaps, however, the most controversial aspect of the recently published
Social Security Pensions Bill is the proposal to index link the benefits pro-
vided under the State scheme and the equivalent contracted-out benefits
secured under occupational schemes. Although I have a personal and
instinctive dislike of such an arrangement, I suppose one is bound to
agree that it is a feasible proposition where the benefits are financed
on a pay-as-you-go basis. Indeed some might claim that the more involved
Governments are in indexation the more likely they are to exercise some
degree of caution as to what they promise the electorate by way of better
pensions.

However, I agree with those who hold the view that open-ended escala-
tion of benefits secured on a funded basis is another story altogether,
particularly during a period such as we have at present where the rate of
real return on investments generally is less than the general level of
inflation. Clearly, any rate of escalation on benefits expected in the
occupational sector should be limited absolutely, and if the Government
is serious in its intention to encourage the growth of good occupational
In the United Kingdom

schemes on a funded basis, it must bend every effort to curtail the rate of inflation.

In many of the other European countries the level of social security benefits and the contributions required to support them are a great deal higher than those at present prevailing in the U.K. On the other hand the development of occupational schemes in this country is generally more advanced than elsewhere in Europe, and fortunately the various proposals put forward by successive U.K. Governments within the last 13 years to improve overall pension provision have recognised this fact.

My belief is that the financial discipline imposed on Governments by continuing to strive for as much as possible of the overall benefit to be funded by means of sound occupational schemes is likely to be more immediately effective than the other form of discipline to which I have already referred, namely indexation, particularly in regard to the provision of pension benefits. It is my hope, therefore, that Governments can be persuaded not to impose burdens on occupational schemes which they clearly cannot accept and that those who represent the interests of such schemes will have sufficient courage to press this viewpoint—but hopefully on a corporate rather than on an individual basis.

My final comment relates to the authors' observation on the limitations imposed by the Inland Revenue authorities on the scope and size of occupational provision qualifying for the various reliefs. Whilst I have always been an advocate for simplicity and the removal of unnecessary rules and regulations, one has always got to foresee the possibility that a Government which is on the look out for more revenue could be encouraged to either remove or substantially reduce the valuable fiscal concessions granted to occupational schemes if Inland Revenue limits are removed altogether.

My own experience with the Superannuation Funds Office has always been satisfactory, and I am bound to say that in my view their influence on the development and operation of occupational schemes has on balance been for the better. On this issue, therefore, I feel I must disagree with the authors. Having said this, I would add that perhaps there is a good case now for the establishment of a higher limit than two-thirds of final salary for single life occupational pensions—probably nearer 80%, with the present limit of 66% being retained in respect of those who do not contract out of the new State second tier arrangements. These limits would not, of course, include the basic or flat rate State pensions which would continue to be payable in addition.

The authors subsequently wrote:—Since our paper was presented, the Social Security Pensions Act, 1975 has received Royal Assent, although the regulations covering various all-important conditions for contracting out have not yet been published. We are still, therefore, in the situation where it is unclear whether or not contracting out will be widespread in the private sector. However, the changes which have been made as the Bill passed through Parliament do indicate the willingness of the Government, as expressed by Mr. O'Malley, to encourage partnership with occupational schemes. It is to be hoped that the regulations, as finally published, will tip the scales further in that direction.

A considerable amount of the discussion revolved around the question of contracting out and we agree with the several speakers, particularly Messrs. Low, Lyon and Macdonald, who stated that, whatever the ultimate formula for contracting out, by far the most encouraging factor to employers with occupational pension schemes would be an indication that the
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Government, and indeed successive Governments, were capable of keeping inflation under control.

Index-linked investments for pension funds, about which we feel particularly suspicious, were discussed by several speakers. The economic effects of index-linking generally are a subject worthy of further study. In the meantime, however, it is difficult to accept the arguments of those who, on the one hand, ask the Government to make index-linked investments available to pension funds, and on the other, seek to justify contracting out of the only index-linked investment available—here, we fear, is an example of "unenlightened" self-interest.

We were pleased with the weight of opinion which supported our contention that there should be no Inland Revenue limit on the level of pensions provided under approved schemes, although we feel somewhat harshly treated by those who implied that our "limit if there is to be a limit" would be unworkable. Our view is that this would be considerably easier to administer than the present complicated rules. Surely, given the weight of opinion which clearly exists within the profession in favour of a simplification of the present system, the time has come to make a concerted effort to obtain some progress in this direction. Clearly, whatever the eventual content of the regulations, the amount of administrative work involved in running a contracted-out scheme, or indeed an integrated contracted-in scheme, is going to be immense, and any simplifications which can be made at this stage will be particularly welcome. We can see there being an attraction for some employers, therefore, both on financial and administrative grounds, in introducing a money purchase scheme, possibly providing lump sums on retirement sitting on top of the State scheme, if the terms for contracting out do end up as being particularly unpalatable.

A particularly complex area discussed by a number of speakers is the economic effect of funded pension schemes and the long-term security of the resulting pensions. Mr. Lyburn is correct in saying that even where benefits are "secured" under a funded scheme, the payment of pensions of real value to the retired population is still dependent upon the willingness of the working population to forego consumption. This has been clearly illustrated in recent years. However, the existence of funded schemes should have created real savings and contributed to investment and one would be hopeful that, as a result, production would have increased so that everybody would be sharing a larger cake.

Finally, as mentioned above, we welcome Mr. O'Malley's assertion that the Government does indeed want partnership with the occupational schemes in its aim to provide a secure and adequate income for retired people. We feel that his willingness to discuss the points at issue with representatives of the pensions industry in the period up to the passing of the Act has shown that he is as good as his word. However, only the content of the regulations will let us know whether he has been successful.