REFORM

How to run a country: Pensions

William Mosseri-Marlio

June 2015

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1. Introduction

Pensions policy poses a significant, albeit slow burning, challenge for the new Government. The Department for Work and Pensions (DWP) estimates 11.9 million people are undersaving for their retirement.[1] Meanwhile demographic shifts will see yearly expenditure on the State Pension and pensioner benefits grow by 1.7 per cent of GDP between 2015-16 and 2064-65.[2] This is bad news for both public finances and the wellbeing of pensioners.

Action is needed, but caution is also called for. The full implications of policies affecting retirees take generations to emerge, people need time to be able to prepare for their futures, and retirement needs can be complex and varied. When navigating these challenges, the Government should be guided by three principles. Pension policy should:

- Provide a framework for everyone to sustain a healthy level of wellbeing in retirement by alleviating poverty and helping savers meet their aspirations.
- Extend choice to those who seek it, while recognising varying capabilities and the need to design regulatory frameworks which support decision-making.
- Create a financially sustainable system that does not undermine the wellbeing of future citizens through the crowding out of other public services or accrual of debt.

In practice, these principles support a core State Pension aimed at reducing poverty, supplemented by targeted assistance for those most in need, private savings to help individuals maintain their living standard in retirement, and support for pensioners who want to work. By giving individuals a range of tools to smooth consumption, pool risk and liquidate assets, this ‘mixed model’ system offers choice to the individual and financial resilience to the State.

This chapter briefly describes the current pensions system, before exploring how *Reform’s* principles might be realised. It addresses the key pillars of the current retirement framework – state provision, private provision, and income from work – and offers recommendations to the new Government along the way.

2. Current system

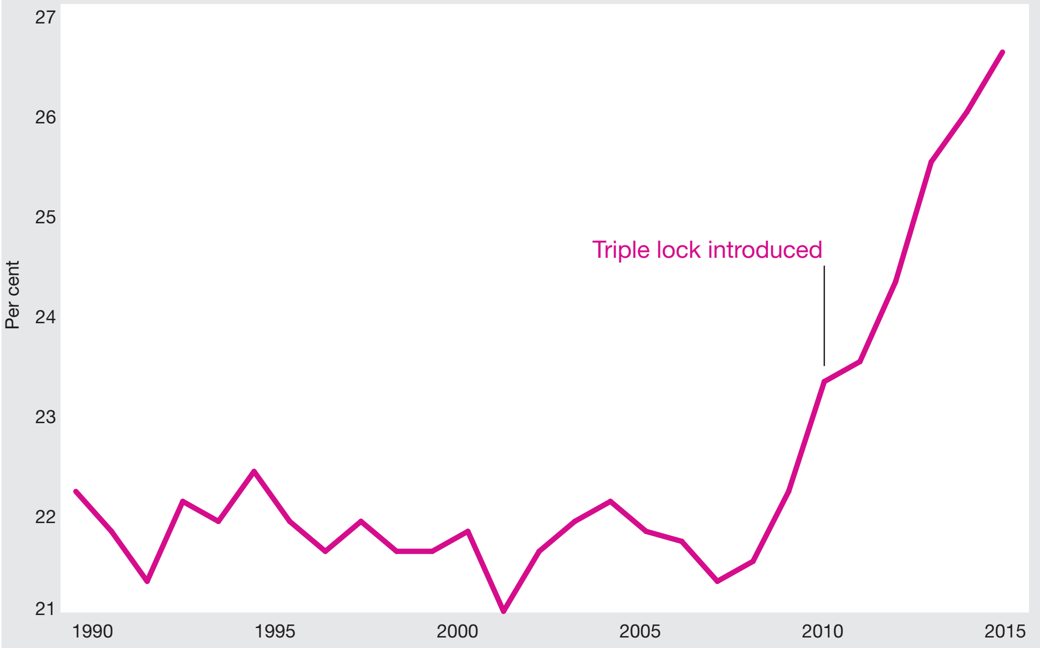
The State Pension is a universal benefit accessible to all who have reached the State Pension Age (SPA). Since 1925, the State Pension has in part functioned on a contributory basis, whereby the level of contribution determined the benefits received. This contributory element has steadily been eroded, and the introduction of the Coalition Government’s ‘Single Tier Pension’ – a flat rate State Pension which combines the current Basic State Pension and State Second Pension – will continue this trend.[3] The new benefit was intended to be simpler to understand, provide greater surety of income, and make it pay to save by placing the rate above the minimum guarantee.

The Coalition Government also introduced crucial changes to the SPA. Uprating of the SPA for women was accelerated, and increases in the SPA to 66 and 67 were brought forward – these were positive steps towards curbing the long run cost of pensions.[4] Five yearly reviews of the SPA were also introduced, giving much needed structure to a politically contentious issue, with supporting documentation setting out the expectation that a third of adult life will be spent in receipt of the State Pension.[5]

1 Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes*, August 2014.
2 Office for Budget Responsibility, *Fiscal Sustainability Report: June 2015,* June 2015.
3 To receive the full single tier pension, individuals will need to have 35 qualifying years.
4 HM Government, *Pensions Act 2011*; HM Government, *Pensions Act 2014*.
5 HM Treasury, *Autumn Statement 2013,* December 2013.

For many years the State Pension was indexed against inflation.[6] This offered protection against rising prices, but during periods of strong wage growth, the relative economic position of pensioners – who were already relatively poor – diminished. The previous Labour Government responded to these legitimate concerns by pledging to reinstate the earnings link by 2012, but the Coalition Government went further by introducing the so-called 'triple lock' in 2010 (see Figure 1). The State Pension is now uprated by the highest out of Consumer Price Inflation (CPI), average earnings or 2.5 per cent, ensuring pensioners benefit from the prosperity of the working population, are protected against inflation, and receive meaningful rises each year. This mechanism will be a significant financial burden on future administrations.

Figure 1: Weekly pensioner income as a percentage of average weekly wage
Sources: Office for Budget Responsibility (2014), *Welfare Trends Report;* Office for National Statistics (2015), *Average Weekly Earnings Database.*



In addition to the core State Pension, pensioners receive various universal benefits, including the Winter Fuel Allowance, free TV licences, and free bus passes. These perks account for just 2.5 per cent of the £121 billion pensioner budget, but it is not money well spent.[7] Pensioners also have access to a means tested Pension Credit, although the introduction of the Single Tier Pension will largely phase this out.

State support in retirement is supplemented by private pension provision, a market that has changed significantly over the last fifty years. 'Final salary' or Defined Benefit (DB) pension schemes, where members are guaranteed a particular level of income in retirement, have gradually been replaced with Defined Contribution (DC) provision, where individuals and their employers contribute to a pension pot over the course of working life (see Figure 2). A number of factors have caused this shift, including the challenge of longevity, investment risk, a more mobile workforce and changes in legislation.[8]

6 The State Pension was uprated by earnings between 1974 and 1980, after which RPI indexation was used. The Labour Government introduced a 2.5 per cent minimum increase in 2001. (Djuna Thurley, *Pension Uprating: Background*, July 2010).

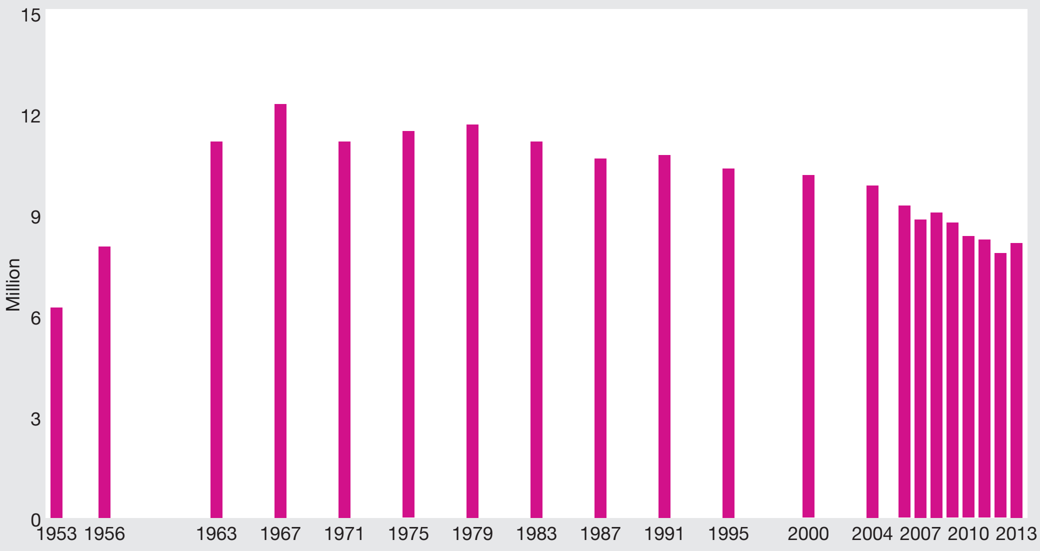
7 Winter Fuel Allowance and free TV licences will account for £2.8 billion of expenditure in 2015-16, however the cost of free buses passes is more difficult to judge. Bus subsidies and concessionary fares cost the Department for Transport £268 million in 2014-15. (Department for Transport, *Annual Report and Accounts 2013-14,* July 2014; Carl Emmerson, Paul Johnson and Robert Joyce, *The IFS Green Budget 2015,* February 2015).

8 Leandro Carrera, *The Changing Landscape of Pension Schemes in the Private Sector in the UK*, June 2012.

Figure 2: Number of active members of private sector occupational pension schemes by benefit structure
Source: Office for National Statistics (2014), *Occupational pension schemes survey 2013.*

The shift to DC pensions has also taken place at a time when the number of individuals participating in a workplace pension has declined (see Figure 3). This trend is beginning to reverse thanks to the welcome introduction of auto-enrolment, whereby employees are enrolled into a workplace pension scheme on an opt-out basis. Implementation of this policy was initiated by the previous Labour administration, continued by the Coalition Government, and will be completed by the new Government. The minimum total contribution rates for these workplace pension schemes will be 8 per cent by 2018, made up of at least 3 per cent paid by the employer (the minimum contribution rate started at 2 per cent and will increase to 5 per cent in 2017). However this policy has come at a price. In addition to the financial cost of mandatory contributions, the Government estimates that the regulatory burden on business as a result of auto-enrolment will be £2.8 billion.[9]

Figure 3: Number of active members of occupational pension schemes
Source: Office for National Statistics (2014), *Occupational pension schemes survey 2013.*



9 Department for Work and Pensions, *Impact Assessment: Workplace Pension Reforms,* May 2012.

Previously pensioners were compelled to purchase an annuity – a guaranteed lifetime income product – with their DC pension pot. Compulsory annuitisation was abolished in 2011, and the 2014 Budget built on these changes. The Chancellor's freedom and choice reforms – which removed the punitive levels of taxation previously levied on those wishing to access their DC savings – was a positive step towards recognising some individuals are not well served by annuities.[10] This adds flexibility to the generous tax treatment of pensions. Contributions are broadly exempt from taxation, as are investment returns.[11] And while pension income is subject to tax at the marginal rate, a quarter of savings can be accessed tax free. This system is typically known as EET (Exempt, Exempt, Taxed).

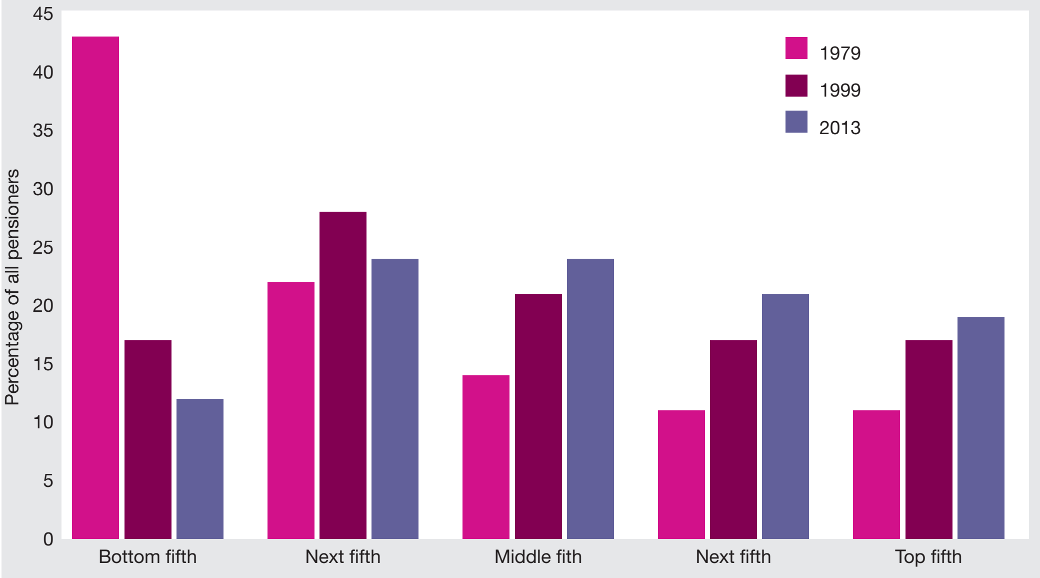
3. A more sustainable and targeted state pillar

The OBR projects public expenditure on pensioners will rise from 6.3 per cent of GDP in 2015-16 to 8.0 per cent of GDP in 2064-65.[12] While some of this growth is the inevitable result of a society with more pensioners, the vast majority is because of an increasingly generous State Pension.

Historically there may have been a rationale for this: pensioner poverty was a considerable public policy problem until the early 2000s.[13] However this is no longer the case. Once housing costs are taken into account, median pensioner incomes are now higher than non-pensioner incomes.[14] This is not to say all pensioners are well off – clearly that is not true. But it does mean that increasing universal transfers to a group that is now relatively affluent will mean fewer resources for those in greater need (see Figure 4).

Figure 4: Pensioners' position in the overall net income distribution, after housing costs

Source: Department for Work and Pensions (2014), *The Pensioners' Incomes Series.*



10 As Baroness Altmann has argued, "the annuity will cover against one risk. It is like buying a house and insuring against fire. The annuity will cover you against the risk of living a very long time, but there are many other risks in retirement that people face that certainly a standard annuity will not cover you for. It is like having fire insurance but then you get flooded or burgled and you do not have any cover. The standard annuity will not cover you against inflation or for a partner." (House of Commons Treasury Select Committee, *Budget 2014, Thirteenth Report of Session 2013-14*, May 2014).

11 Tax-free contributions are subject to annual and lifetime limits. Returns on savings can be affected by both corporation tax and stamp duty on share transactions. (Emmerson, Johnson and Miller, *The IFS Green Budget 2014*).

12 Office for Budget Responsibility, *Fiscal Sustainability Report: June 2015*.

13 Tom McInnes, Hannah Aldridge, Sabrina Bushe, Adam Tinson and Theo Barry Born, *Monitoring Poverty and Social Exclusion 2014*, 2014.

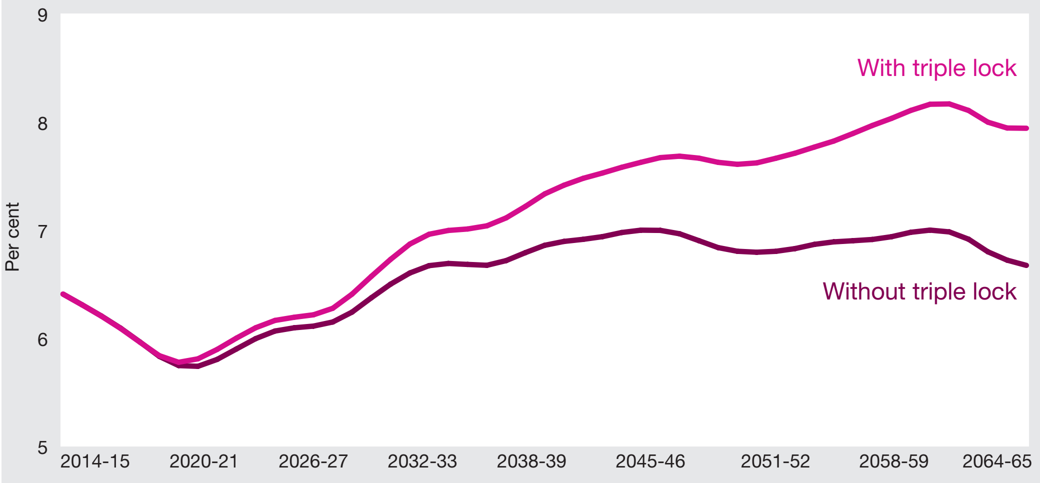
14 Andrew Hood, "Pensioners Are Now Richer than the Rest and We Should Celebrate That," *Daily Telegraph*, 24 February 2015. As DWP has noted, incomes after housing cost is the best measure for pensioners since three quarters currently own their homes outright. However even before housing costs are taken into account, 20 per cent of all pensioners are in the bottom quintile of the overall population net income distribution – average for the overall distribution. (Department for Work and Pensions, *The Pensioners' Incomes Series,* July 2014).

3.1 A sustainable State Pension

The triple lock ensures pensioners make relative gains on non-pensioner households whenever earnings growth is surpassed by inflation or 2.5 per cent. This ratchet effect is costly. Compared to earnings indexation, the impact of the triple lock by 2064-65 will be an increase in *annual* State Pension expenditure equivalent to 1.3 per cent of GDP (see Figure 5).[15] Indeed, the triple lock is the primary driver of long-term spending growth on pensioners, accounting for more than 80 per cent of increased expenditure over the time period.[16]

Figure 5: Expenditure on the State Pension and pensioner benefits as a percentage of GDP, with and without the triple lock[17]

Sources: Office for Budget Responsibility (2015), *Fiscal Sustainability Report.*



A radical way of better targeting the State Pension would be to means test it altogether. Whilst initially attractive, there are significant concerns about the effect this would have on incentives to save, particularly with 11.9 million of the current workforce already not saving enough to maintain their standard of living in retirement.[18] One way of resolving this would be the introduction of mandatory savings, much like in Australia. However this is an unattractive proposition. Compulsion will adversely affect those – such as individuals with volatile income streams – who have little reason to save consistently. Indeed from the perspective of personal wellbeing, people are far better placed than the State to make decisions about their retirement.

These considerations mean the new Government should adopt an alternative approach. Given the relatively affluent position of pensioners, the future generosity of the State Pension should be curbed by dropping the triple lock in favour of a mechanism that still maintains a basic standard for all. One option would be to introduce a 'double lock', whereby the minimum guaranteed increase of 2.5 per cent would be scrapped. Relative to earnings indexation, this option has the benefit of protecting pensioners' purchasing power during periods of negative real wage growth. However given the relatively few instances when both inflation and wage growth have fallen below 2.5 per cent in the last century, it is likely the long run cost of the double lock will be similar to the triple lock.

Instead, the new Government should introduce a 'relative earnings link', a system similar to that implemented in Australia.[19] Under this mechanism, the State Pension is uprated by a suitable index of inflation, however it is never allowed to fall below a certain proportion of earnings – 'the benchmark'. During economic downturns, when inflation often outstrips

15 Department for Work and Pensions, *Pensions Act 2014 Impact Assessments: May 2014,* May 2014.
16 Ibid.
17 OBR projections assume continuation of the triple lock, and that a third of life expectancy will be spent in retirement.
18 Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes.*
19 Australian Government, *Common Provisions Affecting Indexation of Pensions,* May 2015.

earnings growth, the relative earnings link means the State Pension is uprated in line with prices. As a result, pensioners' incomes grow more than those of non-pensioners, and the State Pension as a proportion of average earnings increases above the benchmark. However, this period of generosity is eventually corrected when prosperity returns and wage growth surpasses inflation. Non-pensioner incomes appreciate faster than pensioner incomes, and pensioner incomes as a proportion of average earnings fall. This trend continues until the benchmark is hit, when the State Pension is again uprated by the earnings index.

This mechanism has two significant benefits. Unlike the earnings link, pensioners are not hit by increases in inflation during periods of declining real wages. This is particularly important given pensioners will struggle to respond to price rises by re-entering the labour market. But the relative earnings link also avoids the ratchet effect of the double or triple lock while maintaining the relative economic position of pensioners. If the relative earnings link locked pensioner incomes into the proportion of wages they are at now, the State Pension would be roughly 10 per cent lower by 2060 than would be the case under the triple lock.[20] The relative earnings link, therefore, could save a significant proportion of the costs of the triple lock while maintaining the desirable features of the current system.

Recommendation

The Government should uprate the State Pension through an Australian-style 'relative earnings link', which increases payments with earnings during normal years but allows temporary flexibility during periods of high inflation.

3.2 Middle-class welfare

The relatively affluent position of pensioners means that forthcoming increases in the State Pension delivered by the triple lock are unlikely to promote wellbeing efficiently – these resources could be better spent on those in greater need. The principle underlying this reform also indicates change is needed to universal pensioner benefits. The Winter Fuel Allowance and free TV licence cost £2.8 billion each year, but they do not present good value for money.[21] Only 12 per cent of recipients of Winter Fuel Allowance are in fuel poverty and there is no strong policy rationale for free TV licences.[22]

The Government should scrap these benefits, and combine them into a cash transfer for those paying no income tax on their pensioner income. This would both protect vulnerable pensioners and free up resources that could support wellbeing more efficiently elsewhere. However the free bus pass should be kept in place. The cost of this measure is significantly lower than the other universal benefits, and given the extensive literature on the effect of loneliness on wellbeing, there is at least a policy rationale for its continuation.[23]

However means testing presents the problem of uptake – between 32 and 38 per cent of pensioners eligible for pension credit are estimated to not claim it.[24] Much like the State Pension, there is also the question of whether a means tested cash benefit would affect incentives to save. While significant, these obstacles are not insurmountable. Take up of pensioner credit is poor due to complexity. And while a means tested cash benefit may erode incentives to save, these low income recipients would not have been in a position to save in the first place. Indeed, low income groups are relatively well placed to maintain their living standard in retirement: DWP research found only 1 per cent of undersavers are in the lowest income band (under £12,300 per year).[25]

20 Department for Work and Pensions, *Pensions Act 2014 Impact Assessments: May 2014.*
21 Emmerson, Johnson and Joyce, *The IFS Green Budget 2015;* Department for Transport, *Annual Report and Accounts 2013-14.*
22 Patrick Nolan, *The Fairness Test,* March 2011.
23 Bus subsidies and concessionary fares cost the Department for Transport £268 million in 2014-15.
24 Lucy Radford, *Quantitative Evaluation of the Pension Credit,* 2012.
25 Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes.*

Recommendation

The Government should scrap the Winter Fuel Allowance and free TV licence, with cash support reserved for the most vulnerable pensioners. To combat pensioner loneliness, it should retain free bus passes.

4. Strengthening the private pillar

The existing system of state support for pensioners is unfunded. Today's workers are not asked to pay for their own retirement, but for the retirement of the current cohort of retirees. This arrangement is perfectly sustainable when the ratio of workers to pensioners is either constant or growing. But it is not when increasing longevity reduces the number of workers available to support pensioners. As a result, the shortfall between the National Insurance Contributions of today's workers and the amount being drawn down by the current cohort of retirees will have to be made up through general taxation, spending cuts, or debt.

One way of avoiding this transfer of wealth between generations is to encourage individuals to save for their own retirements, rather than rely on the State to smooth their income via taxation. This not only avoids the deadweight losses of the tax system. It also gives individuals the opportunity to plan for their retirement in ways they see fit.

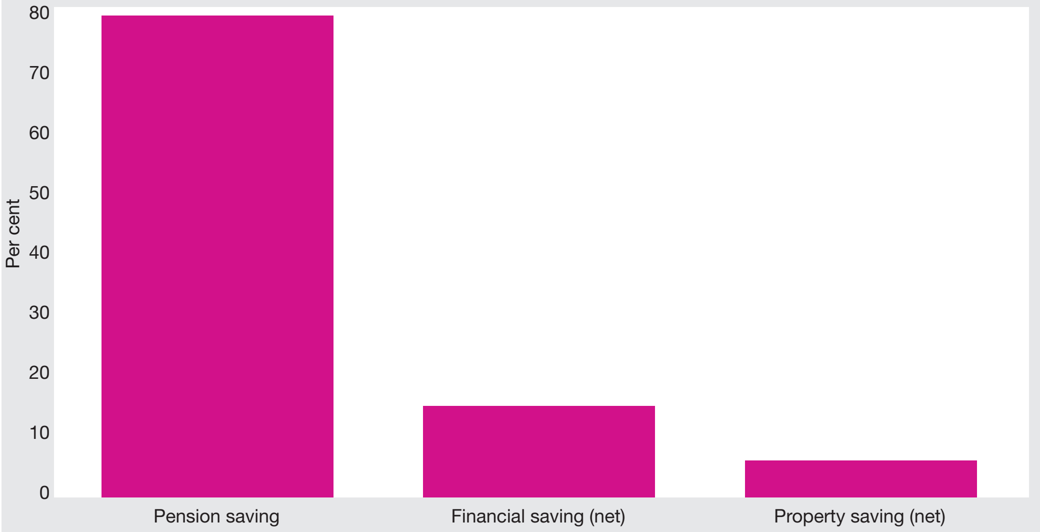
However, concerns of a 'savings gap' have been fuelled by the fall in pension scheme participants and the transfer to less generous DC schemes, where contribution rates are half those of DB schemes.[26] In itself, these trends do not confirm the existence of a savings gap – pensions are not the only savings instrument available. But they are by far the most significant element of household savings (see Figure 6).

Policymakers' concerns are further supported by DWP projections of 'adequate replacement rates' – a measure of the extent to which an individual's savings will help them maintain their living standards in retirement.[27] Even after the effects of auto-enrolment are taken into account, 11.9 million people currently in the workforce will not be able to sustain their present standard of living in retirement.[28] Middle and high income earners are most exposed: indeed, 67 per cent of earners over £52,000 will face inadequate incomes in retirement.[29] If individuals in this segment of the population are to maintain their standard of living in later life, they will need to save a considerable proportion of their income – something that is clearly difficult at the moment.

26 Department for Work and Pensions, *Framework for the Analysis of Future Pension Incomes*, September 2013.
27 Ibid.
28 This figure might underestimate the true scale of the problem. DWP projections currently assume the State Pension will be uprated by the triple lock, a policy that - as 6.2 highlighted - will prove costly in the long run. (Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes*).
29 Ibid.

Figure 6: Aggregate net saving in households where the household head is aged 50-64

Source: Office for National Statistics (2013), *Pension Trends Chapter 10: Saving for retirement.*



4.1 Removing barriers to saving

These findings are exactly what behavioural economics would suggest. Procrastination, status quo bias, loss aversion, and hyperbolic discounting mean individuals who want to save struggle to do so.[30] This does not mean the Government should be able to decide whether, and how much, an individual should save. Instead, it should provide a framework in which individuals can more easily take action to save for themselves.

One such attempt was the introduction of auto-enrolment. The policy has already enrolled 5.2 million into a workplace pension, however concerns remain.[31] The staging of small businesses – those who are likely to have less experience of workplace pensions – is only now taking place. Indeed, just 3 per cent of employers have joined the auto-enrolment network, with the remaining to enrol their staff between 2015 and 2018. [32] More importantly, it is too early to tell whether auto-enrolment has succeeded in encouraging *additional* savings, and evidence from overseas is not wholly positive. The New Zealand Treasury, in its initial evaluation of their own auto-enrolled pension scheme, concluded "in the long run, the effect on net national saving appears marginal at best."[33]

Despite these challenges, the next step must be to support those who want to increase their contribution rates. Evidence suggests 'auto-escalation' – whereby individuals pre-commit to increasing their contribution rates when their pay increases – could significantly help. Trials in America found savings rates for those enrolled into an auto-escalation scheme increased from 3.5 per cent to 13.6 per cent, and that retirement income projections for participants aged 25 nearly doubled.[34] Crucially, these schemes helped even those on very high incomes improve their replacement rates – the group most at risk of disappointment in the UK.[35]

If the State were to require all pension schemes auto-escalated, regulatory and administrative burdens would be significant. Indeed, in America, schemes as such 'Save More Tomorrow' have been run out of private companies, rather than the federal

30 Richard Thaler and Shlomo Benartzi, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economy* 112, no. S1 (2004).
31 The Pensions Regulator, *Automatic Enrolment: Declaration of Compliance Report, July 2012 - End April 2015*, May 2015.
32 National Employment Savings Trust, *NEST Insight 2015: Taking the Temperature on Auto-Enrolment,* 2015.
33 David Law, Lisa Meehan and Grant MacDonald Scobie, *KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving,* December 2011.
34 Thaler and Benartzi, "Save More Tomorrow."
35 Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes.*

government. But the State could require that every pension scheme gives individuals the option to opt into, or out of, an auto-escalation programme. The Government should review the feasibility of this option, as well as evaluate measures to help those marginalised from the auto-enrolment system, such as the self-employed.[36]

Recommendation:

The Government should conduct a feasibility study of auto-escalation, as well as evaluate measures to help those marginalised from the auto-enrolment system, such as the self-employed.

4.2 Tools for retirement planning

A significant cause of inadequate savings is the complexity of retirement decisions. Savers need to juggle a number of risks, including longevity and inflation, and the new environment of freedom and choice makes retirement decisions harder still. To tackle this, the Government unveiled Pension Wise to help support retirees understand their options, the benefits and risks of each, and how these relate to their own circumstances and needs. However the scale of the 'advice gap' is considerable. Two thirds of members of a DC scheme need help reviewing their financial situation, while three quarters need help calculating the total income they will receive in retirement from all sources.[37] Ensuring individuals can confidently access this type of basic information is absolutely necessary if savings rates are to increase.

One way of addressing this issue – tabled by Mark Hoban MP in a report for *Reform* earlier this year – would be to create a RetirementSaverService.[38] The platform would bring together information on an individual's pension(s) and other savings data, give users the tools to build a retirement plan, and offer tailored guidance that would bridge the gap between limited guidance and regulated advice.[39] In its yearly review of pensions, the OECD spoke favourably of these types of systems, and the Financial Conduct Authority (FCA) recommended "in the longer term, the creation of a pensions dashboard which will allow the consumer to see all their pensions in one place."[40] This is welcome news, but the Government should implement this policy faster than the timeline of "a few years" set by the FCA. This tool could be crucial in helping savers understand this new environment – the sooner it is available, the better.

Recommendation

The Government should accelerate and prioritise the roll out of the Pensions Dashboard.

4.3 Tax treatment of the private pillar

A strong private pillar also needs a stable tax framework that encourages savings. But as previously noted, the biases that affect behaviour lead to less saving than lifecycle models would otherwise suggest. There is a case, therefore, for the Government to encourage saving through tax incentivises. However, the current system is expensive, costing the Exchequer £35 billion in 2013-14; and regressive, with two-thirds of relief going to higher and additional rate payers.[41] The Conservative Party manifesto was alive to these issues, and contained a commitment to reduce the annual allowance to £10,000 for those earning £210,000 or more. However, as the IFS has shown, this policy would distort the labour market through punitive marginal tax rates at higher levels.[42]

36 Steve Webb suggested the Statutory Review into Auto-Enrolment planned for 2017 may no longer be necessary.
37 Barclays, *Steps Towards a Living Pension*, 2014
38 Mark Hoban, *RetirementSaverService*, January 2015.
39 Ibid.
40 OECD, *OECD Pensions Outlook 2014*, December 2014; Financial Conduct Authority, *Retirement Income Market Study: Final Report: Confirmed Findings and Remedies,* March 2015.
41 HM Revenue and Customs, *Personal Pension Statistics 2015*, February 2015; Hansard, "Tax Allowance: Pensions," 6 July 2011.
42 Carl Emmerson and Paul Johnson, "Conservative and Labour Proposals to Cut Pensions Tax Relief for Those with an Income above £150,000," 12 April 2015.

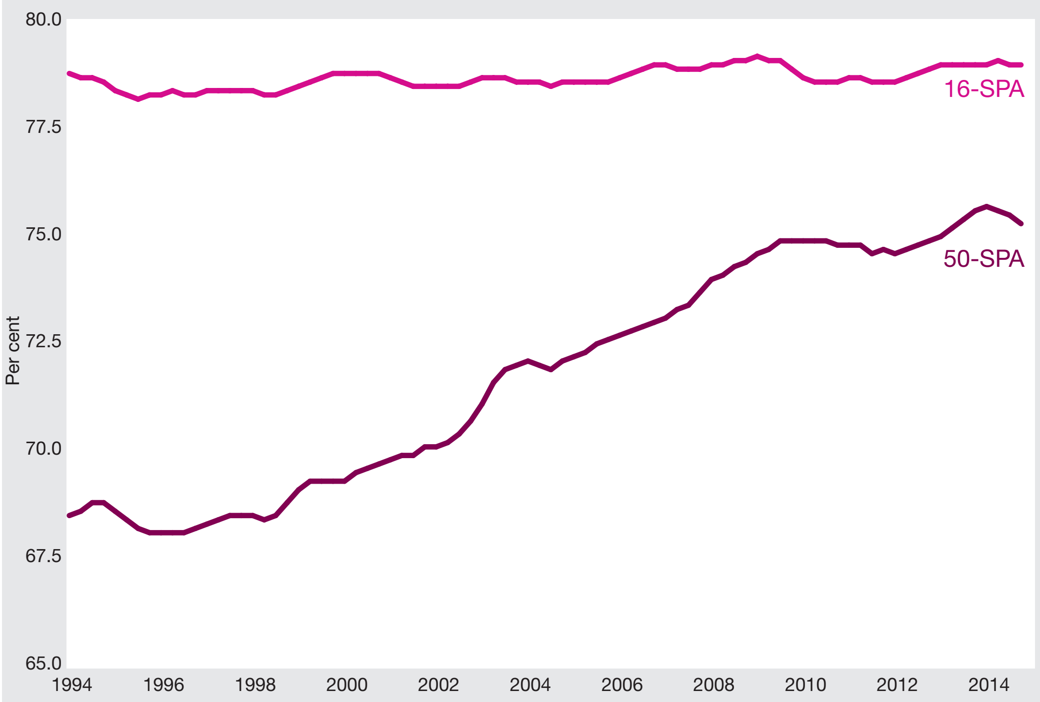
The policy is also indicative of the approach successive administrations have adopted to tax relief reform, where interventions are seemingly evaluated in isolation rather than in the broader context of the tax system. To put tax relief on a more solid grounding, the Government should set out the principles against which the existing framework should be evaluated. This would formalise the Government's rationale for tax relief, guide future reform, and give certainty to savers who are concerned the rules of the game will change later down the line. However, a particular emphasis should be placed on what is an effective way of encouraging saving, and on those groups least likely to secure an adequate level of income in retirement.

5. Support for work in later life

If more individuals are to maintain their standard of living in retirement, pension contributions will need to increase. But private pension savings are also significantly affected by the extent to which an individual can stay in the labour market in later life. Remaining in work up to, or even beyond, pensionable age gives individuals more years to accumulate assets, but it also avoids premature drawing down of savings. Indeed, the DWP estimates that a moderate uplift in employment for those aged between 50 and the SPA would improve retirement income adequacy for 250,000 of the current workforce.[43]

However, the positive impact of longer working lives extends beyond financial considerations: there is evidence that part-time work in later life has a positive impact on wellbeing, while delaying retirement is thought to improve health outcomes.[44] Literature on ageing labour markets also indicates that productivity gains from blending younger and older workers could help offset the fiscal strains resulting from the UK's changing demographics.[45]

Figure 7: Labour force participation by age
Source: Office for National Statistics (2015), *Participation rates in the UK labour market, 2014.*



43 Department for Work and Pensions, *Scenario Analysis of Future Pension Incomes.*
44 Gabriel Heller Sahlgren, *Work Longer, Live Healthier*, May 2013; Deborah Smeaton and Sandra Vergeris, *Older People inside and Outside the Labour Market: A Review*, January 2007.
45 Ross Guest, *Population Ageing and Productivity: Implications and Policy Options for New Zealand*, 2013.

Encouragingly, participation rates for those aged between 50 and the SPA have increased in recent years (see Figure 7). The abolition of the default retirement age in 2011 was an important reform, as was the pegging of the private pension age to the SPA. However the Coalition Government failed to accompany these measures with initiatives specifically targeted to support older workers who want to re-enter, or remain in, the labour market. The Work Programme, the Coalition Government's main welfare to work initiative, has not performed well for older workers. The job outcome rate for those aged 18 – 24 is 30.8 per cent, but only 15.3 per cent of those older than 50.[46] Without the right support services, further increases in the employment rate for older workers will be very difficult.

Of course, as the new Pensions Minister Baroness Altmann set out in her report earlier this year, the barriers to employment in later life are complex, including issues as disparate as the stigmatisation of older workers, inflexible working, and health and social care policy.[47] But later life employment will improve little unless the Government tackles the skills gap amongst older workers. The European Foundation for the Improvement of Living and Working Conditions (Eurofound) recently concluded that, relative to their European counterparts, the UK's current cohort of older workers suffer from low levels of education, poor qualifications and a lack of transferable skills.[48] In large part this has been the result of technological advances. Employers are increasingly demanding workers with advanced computer and technology skills, criteria that are more likely to lock out older workers.[49]

The Government should, as a matter of priority, develop a better understanding of the skills needs of older workers and test different ways of delivering employment services for this group. This should be jointly owned by DWP and the Department for Business, Innovation and Skills, both of whom would benefit from higher labour market participation rates. In designing the next iteration of the Work Programme and its pricing structure the DWP should also take account of the additional barriers to employment that older age can bring. Providers must be sufficiently incentivised to deliver the level of support needed to improve the job outcome rate of participants aged 50 and over. Without improved support, increases in the SPA are likely to lead to increased reliance on working age benefits, adversely affecting the wellbeing of older people and placing additional strain on the welfare state.

Recommendation

The Government should develop a skills and welfare to work strategy that specifically targets the needs of older workers who want to remain active in the labour market.

6. Conclusion

The Coalition Government unleashed a pensions revolution, unveiling a new Single Tier Pension, implementing auto-enrolment, radically increasing the SPA and introducing freedom and choice at the decumulation stage. A number of these reforms are welcome developments, but what has been missing is a coherent framework that ties the various strands together, focused explicitly around the wellbeing of current and future pensioners. Such an approach would see the Government create a better targeted and more sustainable State Pension, create a structure that helps individuals adequately prepare for retirement through private savings, and support older workers who want to remain in the labour market. Implementing these reforms will be a significant step towards meeting the challenge posed by inadequate savings and the impact of an ageing society on the public finances.

46 Department for Work and Pensions, *Work Programme Statistical Summary*, March 2015.
47 Baroness Altmann, *A New Vision for Older Workers: Retain, Retrain, Recruit,* March 2015.
48 Eurofound, *Role of Governments and Social Partners in Keeping Older Workers in the Labour Market*, April 2013.
49 Carl Van Horn, Kathy Krepcio and Maria Heidkamp, *Improving Education and Training for Older Workers,* March 2015.