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Can everybody afford an employment-based pension?

(Dr Frank Eich)

One of the new Government's more low key announcements in the realm of pensions has been that it intends to review the scope, structure and costs of NEST, the National Employment Savings Trust. This review will apparently be conducted swiftly over the coming months.

NEST represents a cornerstone of the previous government's pension reforms, which followed the 2006 recommendations of the Pensions Commission headed by Adair (now Lord) Turner. It is scheduled for launch in 2012, with employer and employee contribution rates starting at 1 per cent each but then gradually increasing to 3 per cent and 5 per cent respectively by 2017. Other important planks of the reform included the re-indexation of the basic state pension to earnings growth from 2012 onwards and the gradual increase in the state pension age to 68 years by the mid 2040s. The new Government has already announced it intends to bring forward the former date by one year and has indicated that it would like to be more ambitious with respect to the latter date too.

The creation of NEST was seen as a very important step to helping millions of people currently without any employment-based pension start saving for retirement. Most of these are on low to modest incomes and would under previous arrangements have relied on modest state transfers for income in retirement. It affects more women than men. This aspect of the British pension landscape is at least as worrisome as the decline of private sector defined-benefit pensions over recent years or the size of the public sector pension promise.

Fortunately there was and continues to be sufficient cross-party consensus on key characteristics of NEST, including that auto enrolment is a good thing. Evidence from other countries including New Zealand suggests that enrolling employees automatically into pension schemes can lead to a significant increase in the number of people contributing to such scheme. All parties also agree that the UK needs a new savings culture. But there are also signs that support for some aspects of NEST are softening as a recent debate in the House of Lords demonstrates.[1] According to Lord Freud, Parliamentary Under Secretary of State for Welfare Reform, the Government's review will look among other things at the scope of existing plans. Of particular concern is the potential impact NEST might have on employers, in particular small employers.

This is understandable. When the Pensions Commission made its recommendations and the then government embarked on its ambitious reforms, the economic climate was benign and the outlook rosy. Since then Britain has suffered the deepest recession in living memory and the country is only slowly clawing itself back to normality, with the economy remaining fragile and the prospects of a "double dip recession" on everybody's mind. Small businesses in particular might feel that they will not be able to cope with a new employer pension contribution – however small. Many might feel that it is just another "tax on labour", which they could ill afford in the current climate. Not currently mentioned by the Government but perfectly possible is that low income workers might come to the same conclusion.[2] With this week's Budget paving the way for tax increases and substantial spending cuts (including on welfare), everybody will feel the pain. The fact that New Zealanders happily embraced the Kiwi saver during the good times last decade might not offer much of a guide for potential behavioural changes in the bad times; we are now living in a different world. Perhaps starting a new personal pensions saving culture in the aftermath of the deepest recession in living memory and ahead of a sharp fiscal consolidation, which will affect every household's disposable income, is not that easy after all. It just raises one question: when will there ever be a good time to start saving for retirement?

[1] *Pensions: Automatic Enrolment – Debate: To call attention to Her Majesty's Government's plans to introduce automatic enrolment in workplace pensions; and to move for Papers*, House of Lords 10 June 2010.

[2] See *Back to the drawing board: the economic crisis and its implications for pension provision in the United Kingdom*, Dr Frank Eich and Dr Amarendra Swarup, Pension Corporation Research June 2009, which made these points already last year.