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**PENSIONS CRISIS: A FAILURE
OF PUBLIC POLICYMAKING**

Association for Accountancy & Business Affairs

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**PENSIONS CRISIS:
A FAILURE OF PUBLIC POLICYMAKING**

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**ISBN 1-902384-10-5
ISBN 978-1-902384-10-8
EAN 9781902384108**

**Published in 2006
Association for Accountancy & Business Affairs
P.O. Box 5874, Basildon, Essex SS16 5FR, UK.**

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EXECUTIVE SUMMARY

A decent pension is literally a matter of life and death. Low pensions condemn people to poverty. Britain has one of the lowest state pensions among the industrialised western countries. Many people have saved for pensions through occupational pension schemes and personal pension schemes, only to find their retirement security shattered. Too many companies are closing final salary schemes, or not providing any pension scheme. In many cases, employees are making higher contributions for lower pensions. Such tactics help to increase company profits, but do nothing for social cohesion, justice and fairness. Companies are closing or diluting good pension schemes, while their executives enjoy bumper pension pots. Many self-employed people have paid into personal pension plans, but get derisory returns.

Income and wealth inequalities make many unable to save enough for retirement. Successive governments have made poor public choices and created the terrain for the current pension crisis. These include permitting companies to take pension holidays, treating pension scheme surpluses as company profits and funding redundancy costs through pension scheme funds. Not enough has been done to eliminate the gender pay gap and as a consequence women are trapped into low pensions. Regressive taxation policies have eroded the incomes of people on low wages and the minimum wage is too low to provide any effective solution to low pensions. Better pensions could be funded by clamping down on organised tax avoidance and evasion, which results in an annual loss of £97 billion - £150 billion, but little has been done to tackle it.

Due to high cost of housing, gas, electricity, water, transport and council tax, many people do not have an enough disposable income to invest in pensions. Many Britons do not even have adequate resources to get on the housing ladder. Debt-ridden graduates are struggling to pay debts. Some companies have looted employee pension funds and the finance industry constantly finds new ways of picking people's pockets, but regulators don't stop it. Rather than investing in real assets, pensions savings are gambled on speculative investments.

This pension crisis is not due to some invisible hand of fate. It is the result of poor public policy choices. The key priority to solve it must be to redistribute wealth, adopt progressive taxation policies, raise the state pension, pay decent living wage, require companies to honour their pension agreements and end the finance industry's excesses.

CHAPTER 1

BACKGROUND TO THE PENSIONS CRISIS

POVERTY OF PUBLIC POLICYMAKING

The media warn of an impending pension crisis. There is a crisis when retired citizens find that the amounts they receive from the state, occupational pension schemes or their own pension schemes are too low and they can barely make ends meet. It is a crisis for workers because to boost company profits and appease stock markets, companies are closing down good pension schemes, or reducing the future benefits to employees. Many self-employed have seen the returns on their personal pension schemes decline because of mis-selling by the finance industry. It is a crisis when those nearing retirement age, after a lifetime of toil and sweat, and payment of taxes, can only look forward to a measly pension and a drastic decline in their standard of living. Yet in the face of all this corporate barons threaten governments, which consider raising taxes to pay for better pensions, by moving somewhere else, whilst continuing to make profits in the domestic markets. Instead they want the government to reduce public expenditure and force employees to buy private sector pension plans because that increases company profits. Too many are not keen for their companies to provide decent pension security for their employees.

The pension crisis springs from the obsession with reporting higher corporate profits, returns and performance related executive salaries. Corporations engage in off balance sheet financing, accounting dodges and tax avoidance to improve earnings. The pension debate is being used by many to shift costs from companies to employees and retired citizens. “Even in blue-chip companies, whose management once built factories and market share, operating management becomes an endless series of cheap financial dodges: this year’s target is met by ending the defined benefit pension scheme¹, which saves labour costs, and next year’s dodge is leasing the trucks so that capital appears in someone else’s balance sheet. This work is punctuated and interrupted by major restructurings and changes to ownership where it is financial engineering which is crucial ...²” (p. 109). So the cost of increasing company profits is borne by employees and citizens.

¹ This is a pension scheme where the pension is related to the member’s salary or some other value fixed in advance.

² Froud, J., Haslam, J., Johal, S., and Williams, K., (2000). Shareholder value and financialization: consultancy promises, management moves, *Economy and Society*, Vol. 29, No. 1, p. 109.

Like other western industrialised nations, Britain has an ageing population. Out of a population of nearly 60 million, Britain has around 11.4 million (about 18.5% of the population) older people. Of these over 7 million are women aged 60 or over and over 4 million are men aged 65 or over. The numbers of older people are projected to rise to 12.2 million in 2011, 13.9 million by 2026 and reach 15.3 million in 2031³. A man of 60 could expect to live for another 20.2 years and a woman of the same age for 23.4 years. These demographic trends make particular demands on pensions and wealth sharing. It has become fashionable to blame the UK pension crisis on demographic trends and falling birth rates. Such trends affect the rich people too, but there is little evidence of a pension crisis for company executives, lawyers, financial speculators, ministers, legislators, bank managers, judges, accountancy firm partners or managers of pension funds. Successive governments have done little to ensure that there is an equitable distribution of wealth.

Historically, the UK state pension has always been low. The state pension began in 1909 when a non-contributory pension of 5 shillings (25 pence) per week became payable to persons over 70 and with income of less than 8 shilling (40 pence) a week. Lower amounts were payable to those with incomes up to 12 shillings. This great reform was not what it claimed to be as the average life expectancy was around 50, but despite later tinkering, the state pension remained low. Major reforms only came with the advent of the welfare state after the Second World War. In 1974, the state pension was linked to average earnings.

Successive government have sought market solutions. A second or an occupational pension scheme to enable people to supplement the state pension has been considered to be desirable though not every employer provides it. Many self-employed, women and migrant workers are not in employment long enough to build a sizeable pension pot. Many simply cannot afford to make the required contributions, or take out personal pension schemes and rely upon the state pension to support them in old-age. In 1980, the then Conservative government abandoned consensus politics and with it the link between the state pension and average earnings. In a regressive move, it linked the state pension to an average increases in the retail price index, so pensioners could not benefit from the increased economic prosperity as the rate of inflation is almost always less than the average increase in earnings. Had this link not been broken, by 2006, on

³ Age Concern, (2006). *Older People in the United Kingdom: Key facts and statistics 2006*, London, Age Concern.

average, a single pensioner would have received an additional pension of £53 each week, or £2,756 per annum. A couple would have been better off by about £85 per week, or £4,420 per annum. So the government reduced public expenditure and financed tax cuts by penalising pensioners.

The tax cuts boosted company profits. The corporation tax rate was reduced from 52% in 1982/83 to 35% in 1986/87, and further still to 30% in 1998. However, the increased profits were not used to pay improved pensions. Companies could have been required to make higher pension contributions, or National Insurance Contributions (NIC). But they did no such thing. Instead, companies did the reverse. Often with the tacit agreement of trade unions, they funded redundancy payments from the pension scheme surpluses. Many companies dishonoured the contracts with employees and took pension holidays, i.e. did not make the agreed contributions. Some even swiped the surpluses to boost company profits. But when due to declining stock markets pension scheme surpluses turned into deficits, the same companies were unwilling to make good the deficits. Instead, they have diluted or closed the final salary pension schemes⁴. No regulator, government department or company auditor ever stopped, or prosecuted them for the appropriation of surpluses.

Successive governments have pursued regressive taxation policies that penalised people in lower income brackets. In 1979, the two-tier Value Added Tax (VAT) rates of 8% and 12.5% were replaced by a single 15% rate, which in 1991 rose to 17.5%. Such changes penalised poorer sections of the population because indirect taxes are regressive and poor people generally pay a higher proportion of their wages in indirect taxes. It also reduced their ability to save or invest in pension schemes. In 1979, the rich benefited from a reduction in the top rate of income tax of 83%, which today stands at 40%, though the middle classes faced a variety of stealth taxes through erosion of the thresholds for higher tax rates, the value of personal allowances, abandonment of the married couples' allowance, mortgage tax relief and a variety of other tax allowances. In 1997, Labour government changed the taxation of pension scheme income and some commentators believe that this has resulted in an annual reduction of around £5 billion in the monies going to pension schemes. They conveniently ignore the fact that the government also reduced corporation tax rates⁵.

⁴ This is a defined benefit pension scheme that gives individuals a pension based on the number of years of pensionable service, the accrual rate and final earnings as defined by the scheme.

⁵ "City exaggerated pensions crisis", The Guardian, 3 July 2005.

In 1999 Labour administration sought to tackle some of the inequalities by introducing the national minimum wage, set at a very low amount of £3.60 per hour. However, it also legalised discrimination against young workers by requiring that workers under 22 years of age need not be paid even the minimum wage. Nevertheless, the national minimum wage was opposed by the Confederation of British Industry (CBI), the Conservative Party, a variety of employer organisations and even professional bodies keen to curry favour with corporate barons. For example, the Association of Chartered Certified Accountants (ACCA) opposed the introduction of a modest national minimum wage whilst its own chief executive picked up £200,000 in salary and retired on a pension of £125,000 per annum. Those who could set their own remuneration objected loudly to government setting it for the low-paid.

In fact, the disposable income of people in the lower income brackets was being steadily reduced by rising housing, utility and transport costs and the need to pay for glasses, eye-tests, dental treatment, higher education and prescriptions. Pensions were not always an immediate priority for many with young children and trying to get on the housing ladder. Some felt relatively safe in occupational pension schemes. To make matters worse, pension scheme savings continue to be gambled on the stock market where returns are dependent on speculative frenzies, dotcom bubbles and corporate crashes, rather than investment in real assets. Scandals such as the endowment mortgage and pensions mis-selling, Barings, Maxwell, Transtec, Versailles, Enron, Parmalat, WorldCom, Equitable Life and others destroyed billions of pension savings. Companies boasting the best accountants, lawyers and business advisors engaged in a frenzy of organised looting and destruction.

INSTITUTIONAL RESPONSES

The impending pension crisis is portrayed in the press as an economic problem rather than the result of bad public policy choices. This has been given further credence in the report⁶ chaired by Lord Turner, a former Director General of CBI. The CBI and some think-tanks blame workers for the crisis. They live too long and don't save enough. Then have the temerity to want to live their last few years in peace. The familiar solution is to delay the retirement age, make people work until they drop and somehow force people to save more even though income inequalities are

⁶ Pensions Commission (2005), *A New Pension Settlement for the Twenty-First Century*, The Stationery Office, London.

increasing. Lord Turner's report, the CBI and various policy advisers fail to acknowledge that the pension crisis is above all a failure of public policymaking.

The government's White Paper⁷ on pensions proposes that employees should pay 4% of their salary between £5,000 a year and £33,000 a year into a proposed occupational pension scheme to earn a second pension. Employers would, in turn, contribute 3% for the same band of earnings, while the government will contribute 1% in the form of tax relief. Company contributions will be phased in over three years at the rate of 1% each year and some support will be offered to small businesses. From 2012, people will automatically be enrolled into this new low-cost National Pension Savings Scheme (NPSS), with an ability to opt out. The government recognises that for reasons of poverty, some employees might opt out and in that case employers will not have to contribute anything. The state pension age for both men and women is to rise gradually over the next four decades, reaching 66 in 2024, 67 in 2034 and 68 by 2044. The government also proposes that the state pension should go up in line with earnings rather than the rate of inflation, but subject to affordability. This indexation could double the state pension by 2050 compared to a pension linked to the rise in prices. Normally someone needs 44 years of National Insurance contributions or credits to qualify for a full basic State Pension (women born before 6 April 1955 need fewer), though the period can be reduced to 39 years by the Home Responsibilities Protection. The White paper proposed that the qualifying period be reduced to 30 years of national insurance contributions. Some of these proposals have already been opposed by the CBI as some companies do not wish to bear the cost of providing security to employees. The insurance industry is also unhappy with the idea of the low-cost National Pension Savings Scheme as it will lose out on its commissions.

SOME REFLECTIONS

The White Paper does not deal with the fundamental causes of the pension crisis, which are income and wealth inequalities, low wages and poverty. There is no commitment to immediately raise the state pension so that millions of people do not rely on means-tested benefits. It does not require companies to return the monies that they took as 'pension holidays' when they failed to make the agreed contributions to the pension schemes. The proposed contribution by corporations and government to the NPSS is

⁷ Department of Work and Pensions, (2006), *Security in Retirement: towards a new pensions system*, London, DWP.

too low. Many self-employed electricians, carpenters, mechanics, hairdressers, taxi-drivers and others are not covered by the proposals and due to low incomes would not be able to make provision for a second pension. Nevertheless, the CBI expressed “deep disappointment at [the government’s] decision to press ahead with compulsory employer contributions” and goes on to say that raising “the state pension will remove disincentives to save – but the price for a better pension is a higher state pension age, which the Government rightly recognises will have to rise gradually over the long-term⁸”.

Though the White Paper promises additional pensions, closer scrutiny reveals that some costs are being shifted from the state to individuals. Some experts claim that the extra three years of work (i.e. retire at 68) would only generate an additional £3 per week of pension. This calculation is based on the assumption that someone is employed from the age of 25 onwards, with a negligible NI record, on median earnings (around £23,000), working until 68 and saving an additional 5% of the salary into a pension scheme and 1.5% charges, to earn a second pension. Assuming that the state pension is linked to increases in average earnings, at 2006 prices that person would receive an extra pension of just £3 a week for working three extra years.

TABLE 1		
Pensions for a 25 year old, earning £23,000, retiring at 68 and saving 5% per annum		
	Weekly Pension Before The White Paper (£)	Weekly Pension After the White Paper (£)
Basic State Pension	33	73
Second State Pension	67	66
Pension Credit	<u>36</u>	<u>0</u>
Total	<u>136</u>	<u>139</u>

Daily Mail, 26 May 2006.

Tax reliefs (see above) will further boost the total pension, but the whole calculation makes the massive assumption first that someone remains in paid employment throughout their life; second that they will have sufficient

⁸CBI press release, dated 25 May 2006 and available on <http://www.cbi.org.uk/ndbs/Press.nsf/0363c1f07c6ca12a8025671c00381cc7/57f9ba38d827043a80257178005b069f?OpenDocument>

disposable income to save 5% per annum and that third the period is relatively free from stock market crashes.

Nor will making people work until the age of 68 solve the pension crisis. How many people can continue to do manual work until the age of 68? People in manual jobs already have a lower life expectancy than those in professional jobs⁹. Faced with extra stress and pressures, many more will die prematurely. As for forcing employees to make extra financial contributions; that ignores the fact that too many workers are already on low wages and too many children already live in poverty. Many cannot even afford to enter the housing market. Many graduates are debt-ridden and do not have the necessary resources for pension contributions. How would they be able to make additional payments? Due to child rearing and family responsibilities, many women will not be in a position to make compulsory contributions throughout their life. Are they to be condemned to permanent low pensions? What of someone who is disabled or unemployed, are they too to be confined to old-age poverty?

Forced pension contributions cannot improve the UK's lamentable record on savings as many workers, especially poorer ones, will simply switch savings from other sources to NPSS. In many cases, the forced savings will reduce the disposable income of employees with a knock-on effect on the economy. Even when workers save for their pension, their savings are not safe and have been looted, or gambled by the finance industry in the biggest casino of the world, the stock market, rather than invested in the real economy. Any reform of pension must address these key issues – an equitable distribution of wealth, penalties on employers for breaking the pension contracts, and penalties on the financial services industry for looting people's savings. None of these are on the government's agenda, but without them there can be no durable solution to the pension crisis.

STRUCTURE OF THE MONOGRAPH

This monograph consists of six further chapters. Chapter 2 looks at the contemporary crisis and evidence of pension scheme deficits, as measured by contemporary accounting rules. The chapter queries such estimates and also shows how the deficits can be eliminated or drastically reduced.

Chapter 3 shows that the pension crisis is being used to deprive workers of reasonable pensions. Companies are using the crisis to save on pension

⁹ Department of Health, (2005), *Health Inequalities: status report on the programme for action*, London, Department of Health.

costs, improve profits and dividends and dump the cost of pensions on to employees and society. At the same time they are maintaining generous pension schemes for their executives who face no pension crisis.

Chapter 4 shows that policy choices by successive governments have resulted in miserly pensions. The UK state pension is almost the lowest amongst industrialised western nations, condemning many pensioners to poverty and forcing to choose between food, heating and other essentials.

Chapter 5 shows that contemporary public policies are preparing millions of Britons for low pensions and poverty because they are simply not in a position to save for good pensions. Most of Britain's wealth is controlled by relatively few.

Chapter 6 shows that even when people join an occupational pension scheme or save for a personal pension, their monies are not safe. The finance industry is mired in scandals and regulators have done little to protect people's savings. Public confidence in the finance industry is justifiably low.

Chapter 7 concludes with a summary and suggestions for reform. It calls for an equitable distribution of wealth, higher state pension, a decent living wage, enforcement of pension agreements so that companies cannot take pension holidays and for tougher regulation of the finance industry to ensure that people are not robbed of their savings and retirement security.

CHAPTER 2

THE PENSIONS CRISIS: FACT AND FICTION

The pension crisis shows in mis-selling scandals and headlines about deficits in occupational pension schemes, i.e. the claims that liabilities exceed the assets and obligations may not be met. Following the Pensions Act 2004 about 10 million people have received letters¹⁰ telling that their pension schemes have a deficit, with the implication that their pension rights could shrink. The perceptions of deficits and crisis both depend on the accounting techniques used to value, record and report pension scheme assets, liabilities and deficits. Such measurements are highly contestable as the figures can be calculated in different ways. Indeed, the accountancy profession itself has been unable to reach any durable consensus about pension accounting and the rules have continued to change.

THE ROLE OF ACCOUNTING

The key element in the pension crisis is the accounting standards used to measure pension obligations. Such standards are produced by organisations funded and dominated by corporate interests and not the result of flawless techniques. Accounting standards are always the residue of political negotiations and bargaining by the corporate interests. This masquerades as objective calculations. Accounting is a highly partisan social technology. A pension is a deferred wage already earned by hard labour and financial contributions, but accounting logic does not encourage companies to see their side of the contract as an honourable commitment to secure continuity, loyalty or social stability. Instead, it emphasises that employee pension is a ‘cost’ or a burden and ideology suggests that burdens must be reduced and eliminated regardless of the social and personal consequences. Such logic has led to the wholesale destruction of industries and local communities, to improve returns to stock markets and salaries for fat cats. The same pernicious logic is applied to pensions as accounting rule makers actively promote practices that enrich a few and leave millions worse-off.

Financial Reporting Standards (FRS) in the UK are issued by the corporate dominated Accounting Standards Board (ASB). International Accounting Standards (IAS) are produced by the International Accounting Standards Board (IASB), a private organisation funded by corporate interests and with no democratic mandate to make policies that affect the distribution of income, wealth and level of pensions in any society. It even asked Enron, the disgraced US energy giant, for a \$500,000 donation. The company was

¹⁰ The Sunday Times, 1 October 2006.

only too willing to contribute and buy influence on accounting rulemaking¹¹.

Under an earlier UK accounting standard known as Statement of Standard Accounting Practice (SSAP) 24¹², pension obligations were considered to be long-term commitments and did not need to be separately valued on a regular basis or on the basis of today's stock market. This permitted companies to spread pension scheme liabilities over many years and thus did not starkly emphasise the deficits. It also enabled companies to declare pension holidays and many did not make their agreed contributions to the pension schemes. This helped to increase company profits, dividends and executive salaries, all frequently linked to reported profits.

In 2001, SSAP 24 was replaced by a FRS17¹³, which is broadly similar to IAS 19, the international accounting standard on pensions. FRS 17 downgraded the use of actuarial values for assets in a pension scheme in favour of a market value based approach. In the case of defined benefit schemes, the calculations require assumptions about future rates of inflation and pay increases, increases to pensions in payment, earnings on investments, the number of employees joining the scheme, life expectancy and the probability that employees will die or leave the company before they reach retirement age. Companies are required to report an annual cost which is calculated on the assumption that the scheme's liabilities, and the assets that will fund them, are essentially long-term. However, as the value of market securities fluctuates, the requirement for companies to record pension scheme assets at market values leads to wide variations in the cost of providing pensions. In a declining stock market, this results in a bigger charge against a company's profits because the schemes show a deficit. This volatility was largely absent from the accounting rules in SSAP 24.

Despite their subjectivity, such accounting calculations have real economic consequences and are responsible for transfers of wealth and risks, as demonstrated by the current pension debate. They have been used to justify scheme closures and/or dilution of the pension rights of millions of workers. In one survey 86% of respondents felt that the accounting standard (FRS 17) "would make it less attractive to employers to offer a

¹¹ Financial Times, 13 February 2002.

¹² Accounting Standards Committee, (1988), *Accounting for pension costs* (revised October 1992), London, ASC.

¹³ Accounting Standards Board, (2000), *Retirement Benefits*, London, ASB.

final salary scheme¹⁴”. The National Association of Pension Funds (NAPF) added that “75% of businesses would be less likely to offer final salary schemes because of the new standard¹⁵”. Clearly FRS17 has been used to dilute employee pension rights and deepen the crisis.

In accordance with the measurement methods recommended by IAS 19 or FRS 17, the pension scheme deficits for all UK companies may be around £100 billion¹⁶. The deficits for FTSE100 companies have been estimated to be £36 billion in July 2006, compared to £37 billion in July 2005¹⁷. Some of the largest estimates of company pension scheme deficits are as follows:

TABLE 2
SOME OF THE LARGEST UK PENSION DEFICITS

COMPANY	DEFICIT £M	DEFICIT £M
	2005	2004
BAE Systems	5,306	4,339
BT Group	4,781	5,136
Royal Bank of Scotland Group	3,735	2,940
Lloyds TSB Group	3,294	3,218
Unilever	2,848	2,964
Barclays	2,697	2,319

Source: Lane Clark & Peacock (2006).

The pension costs and deficits are subject to a variety of assumptions about the future estimates of stock market volatility, interest rates, inflation rates, life expectancy, salaries, investment returns, tax regimes, payout rates and a variety of other factors. As one expert noted, “a 1% reduction in the assumed investment return on its own could increase the pension cost by typically 20-30%¹⁸”. Conversely, a 1% increase in the assumed investment

¹⁴ http://www.pensions-management.co.uk/news/fullstory.php/aid/126/Jump_in_final_salary_closures.html; accessed 7 Sep 2006.

¹⁵ Sunday Herald, 17 February 2002.

¹⁶ Deloitte 7 Touche press release, 6 October 2006.

¹⁷ Lane Clark & Peacock, (2006), *Accounting for Pensions UK and Europe: Annual Survey 2006*, London, Lane Clark & Peacock (available on <http://www.lcp.uk.com/information/documents/AFPSurvey2006.pdf>).

¹⁸ http://www.lcp.uk.com/information/ssap_introduction.asp; accessed 7 September 2006.

return would significantly reduce the pension scheme deficits. The private sector accounting techniques are also adopted by the public sector and the alleged £460 billion¹⁹ deficit would also be affected by the same factors.

Accounting deficits may appear definite, but there are controversies about the calculations. For example, a “key failing of FRS17 is the choice of discount rate as the AA corporate bond yield. It is arbitrary, as is any discount rate other than the market determined cost of capital for the sponsoring firm. The FRS17 prescription of a lower discount rate overestimates the true pension deficit or underestimates the surplus”²⁰. If instead companies used their weighted average cost of capital, which is the cost at which they borrow or raise money in the market, “most companies in the FTSE 100 would see their pension deficit wiped out”²¹. An HBOS executive added that the “great danger is that it [FRS 17] actually opens the door to Maxwell-type manipulation. By this change, the accountants are enabling [corporate executives] who shift at the right time to actually add a big wedge to their reported profits”²².

Accounting estimates of pension scheme deficits are not necessarily reliable as companies indulge in novel accounting techniques to impress markets, bankers and speculators. By using a device known as “corridor financing”, British Airways has allegedly not recognised pension liabilities of £300 million. Barclays kept a liability of more than £1 billion off the balance sheet²³. Corridor financing enables companies to leave up to 10% of the value of a fund off the corporate balance sheet. Barclays said that it “chose this accounting option because otherwise equity would have been decreased and that would have flattered the return on equity ratio, which is a key measure for the City”. Barclays stressed that though its pension fund had a deficit of £2.5 billion, as measured under international accounting standard IAS 19, its actuaries had measured it as having a surplus of £900m. A KPMG partner explained that the “balance sheet doesn't tell the full story when seeking to understand a company's pension obligations. First, the amounts recognised there may be very different, depending on whether the obligations are recognised in full or under the corridor approach. Second, the assumptions used to calculate the obligations are the key”.

¹⁹ Daily Mail, 27 February 2006.

²⁰ Copeland, S., (2005), *The Failings of FRS17 and the Impact of Pensions on the UK Stock Market*, London, SEI Investments.
(<http://www.seiglobal.com/documents/frs.pdf>).

²¹ The Independent, 22 Aug 2005.

²² Sunday Herald, 23 December 2001.

²³ Daily Mail, 5 March 2006.

ELIMINATING PENSION SCHEME DEFICITS

The fact that a pension scheme is in deficit is not of any immediate consequence unless the schemes had to meet all their obligations today. The deficits may appear to be large, but need to be seen in context. For FTSE 100 companies, they represent three months of pre-tax profits, or equivalent to nine months of dividends, or over five months of 2005 surplus cash flow²⁴. If the FTSE 100 index were to rise to 7,200 by mid 2007, pension deficits would be eliminated altogether.

During the 1980s, most pension schemes were in surplus. One study²⁵ found that despite the 1987 stock market crash, 100 largest companies had a median funding level that was 125 per cent of their pension scheme's liabilities, i.e. there was a surplus. In 1990, another study reported that only six out of 100 companies disclosed a funding level that was below 100 per cent of the pension scheme. British Rail had a surplus of £1.2 billion and the government wanted to use it²⁶. By foregoing the contributions, companies boosted profits and their executives received huge profit related salaries. The surpluses were also swiped by companies to pay for restructuring (e.g. redundancies) costs and reported as part of their profits.

Inland Revenue figures show that during the 1990s company profits benefited from £18 billion of pension holidays²⁷ though employees continued to make their agreed payments. In the five years to 2002, companies with final salary schemes improved their profits by some £1.1 billion, either by eliminating or drastically reducing their contributions²⁸. Pension holidays also took place in the public sector and local authorities. Railway companies and Kent County Council took considerable savings. Royal Mail now claims to have a pension deficit of £5.6 billion but it took a ten year pension holiday. During the 1990s, most British universities took a decade long pension holiday which enabled the government to reduce public expenditure and finance tax cuts for corporations and the wealthy.

The Pensions Regulator has told companies to reduce their deficits over a period of ten years. Some companies are making extra contributions, but too many are taking the easy option of closing or diluting the schemes.

²⁴ Lane Clark & Peacock, 2006, p. 6.

²⁵ Cited on page 135, Smith, T., (1996), *Accounting for Growth*, London, Century Business.

²⁶ The Guardian, 5 February 1988.

²⁷ The Guardian, 10 July 2004; 8 January 2006.

²⁸ TUC press release, 17 November 2003.

Some have developed ‘Special Purpose Vehicles’ to dump the costs. They are transferring the pension scheme to a new company, acting as the nominal employer. This entity does not have the finances to properly support the pension scheme it is taking on. As the employer can’t fund the obligations, it bails out and abandons the scheme²⁹.

Pension scheme deficits could be drastically reduced by requiring companies to repay the employers’ share of the contributions foregone during the 1980s and the 1990s. They won’t. Successive governments have done nothing to ensure that what was taken out should be returned.

Mr. Austin Mitchell: To ask the Secretary of State for Work and Pensions if he will introduce legislation requiring companies who have taken a pensions contribution holiday since 1997 to make the payments not made.

Mr. Timms: We have no plans to do so. The level of contributions paid by the sponsoring employer of a private sector defined benefit pension scheme is determined and reviewed under the rules of the scheme, subject to overriding legislation. From April 1997 schemes were required to be funded above the level of the minimum funding requirement (MFR) before the sponsoring employer could take a contribution holiday.

New scheme funding requirements, replacing the MFR, came into force from 30 December 2005. Pension scheme trustees now have greater powers to frame their scheme's funding strategy and determine the appropriate level of contributions payable by the employer. In addition, from 6 April 2006 current HM Revenue and Customs requirements for pension schemes to reduce an actuarial surplus will be abolished. This will remove a factor which may have played a part in some decisions to allow pension fund contribution holidays in the past. Under the revised requirements sponsoring employers will still be able to take a contribution holiday where the scheme is sufficiently well-funded, but only where the trustees agree that it is appropriate.

Source: Hansard, House of Commons Debates, 13 February 2006, cols. 1689-1690.

A number of companies have paid dividends which exceeded their pension scheme deficits. The Lane Clark and Peacock survey reported that nearly half of FTSE 100 companies disclosed pension deficits in 2005 that were less than their declared shareholders’ dividends in 2005. Vodafone paid dividends of £2.7 billion in 2005, significantly more than its accounting

²⁹ The Times, 9 October 2006.

deficit of £136 million. Twenty four companies declared dividends in excess of twice the amount of their pension scheme deficit³⁰.

Companies could set aside a small percentage of their profits to make good the deficits. Too many are not keen on that either. Governments ever concerned about appeasing the corporate lobby simply wring their hands.

Mr. Austin Mitchell: To ask the Secretary of State for Trade and Industry if he will introduce legislation under which large companies, as defined in the Companies Act 1985, would be required to contribute at least 5 per cent of their profits to employees' pension schemes.

Mr. Timms: I have been asked to reply. We have no plans to do so. The Pensions Commission published their report on 30 November 2005 containing recommendations for reform. This includes a recommendation that employers should make a financial contribution to the pensions of employees who are themselves contributing to a workplace scheme. The Government are now reflecting on the report and are committed to consulting with the public and stakeholders on the key issues as part of the national pensions debate. There is much to be discussed and decided on the detail of the recommendations and our response must meet the five tests we have set out—that is that the overall package of reforms must promote personal responsibility; must be fair, affordable, simple and sustainable.

As far as the specific recommendations are concerned, the Government are ruling nothing in and nothing out. Ministers have asked the Pensions Commission to continue their involvement in the public debate over the next few months.

The Government plan to publish a White Paper in the spring in response to the Pensions Commission's report. The White Paper will set out what legislation will be needed and a planned timetable for reforms.

Source: Hansard, House of Commons Debates, 13 February 2006, col. 1644.

It is perfectly feasible to eliminate pension schemes deficits. UK companies are amongst the most profitable in the world. The average profitability of non-financial UK sector is at record 14.7%, with the services sector achieving 20.1% and the oil and gas sector at 38.7%³¹. KPMG reported³² that 70% of the FTSE 100 companies could repay their pensions deficits

³⁰ Lane Clark & Peacock, (2006), op cit. page 23.

³¹ <http://www.statistics.gov.uk/cci/nugget.asp?id=196>

³² KPMG press release dated 5 June 2006; available on <http://www.kpmg.co.uk/news/detail.cfm?pr=2536>; accessed 25 June 2006.

from surplus cash flow within three years and around 50% within one year. Subsequently, it was reported that a quarter of FTSE 250 companies could pay off their UK pension deficit within a year and just under half (49%) in three years by using their discretionary cash flows³³. Companies in the consumer goods sector of the FTSE 250 are best placed to clear their deficits with available cash flows. The KPMG study showed over 90% could theoretically clear their deficits in less than 10 years. Utility companies in the FTSE 250 were worst placed to clear the deficits with just 25% able to do so in less than 10 years. However, 28% of the companies surveyed lacked any such free cash flow so would need to reduce capital expenditure or dividends to clear their deficits over the medium term.

SUMMARY AND DISCUSSION

Accounting figures sanctioned by the corporate controlled regulators play a key role in creating panic about pension deficits. The figures are then used to justify closure of good pension schemes and provide low pension benefits. Either way, accounting is being used to justify a huge wealth transfer from employees to companies and capital markets. The accounting numbers on which this is based are highly contestable and subjective. Depending upon assumptions and techniques, alternative credible figures can be calculated. Changes in accounting rules are a boon for consultants and accountancy firms as they set their stalls to offer advice for high fees. They advise companies to close final salary pension schemes, but to retain fat cat pensions for company executives. Auditors, hired and paid by company directors, are only too keen to endorse such contestable deficits. All for a fee.

The pension deficits can be reduced or eliminated by periodic additional contributions by companies, or through adjustments to corporate cash flows and dividend policies. Some companies are making additional payments into the scheme, but far too many are dumping the costs on employees and society. Many of these companies took pension holidays when the schemes were in surplus, but now do not wish to return the foregone contributions. Successive governments have failed to compel companies to honour their obligations. Employees don't have adequate rights to resist dilution of their pension rights.

³³ "Discretionary cash flow" is a measure of disposable corporate income and KPMG calculated it by subtracting reported debt interest payments, dividends, tax and maintenance capital expenditure (based on the average reported over the last three years) from reported Earnings before interest, tax, depreciation and amortisation (EBITDA).

CHAPTER 3

MISERY FOR EMPLOYEES: MIRACLES FOR FAT CATS

The sense of security offered to workers by pension schemes is being shown to be illusory. Major organisations, including Abbey National, Clydesdale and Yorkshire Bank, GlaxoSmithKline, Barclays, BBC, Friends Provident, HBOS, IBM, ICI, Iceland, Legal & General, Lloyds TSB, Marks & Spencer, Nationwide, Rolls Royce, Thomas Cook, Royal Bank of Scotland and Whitbread have closed final salary schemes to new employees or abandoned them altogether, or require employees to pay more for inferior pension benefits.

According to surveys published by the National Association of Pension Funds, 10% of the final salary schemes in the private sector closed to new staff in 2004. This compares to 26% in 2003 and 19% in 2002³⁴. A survey of 115 major UK employers, by Aon Consulting, revealed³⁵ that only 27% offered defined benefit pension schemes to new members. This is expected to fall to 18% in 2009. The majority of pension schemes in the survey (61%) are currently closed to new members, but remain open to accrual for existing members. One-fifth of respondents said they were considering closing their schemes altogether in the next 12 months, and four in 10 in the next three years. It is expected that 80 per cent of firms who still offer final salary schemes will close them to new members within five years. More than half said they could also close them for existing employees³⁶. This rapid rate of pension scheme closures means that only 40 per cent of today's workers (11.3 million) are members of an occupational scheme, and the proportion in the final salary scheme is declining³⁷.

The new norm may be lower pensions linked to average lifetime earnings, effectively resulting in lower pensions in return for higher pension contributions and longer working lives. Sainsbury's switched a number of its staff to a career average plan and has now asked them to increase contributions from 4.25% to 7%. One study³⁸ estimates that for a final salary scheme, employers might contribute up to 15%-16% of the salary

³⁴ <http://www.napf.co.uk/news/PR2004/release012.cfm>; accessed on 7 September 2006.

³⁵ Reported in Personnel Today on 31 July 2006 - <http://194.203.155.132/Articles/Article.aspx?liArticleID=36666>; accessed on 7 Sep 2006.

³⁶ Daily Mail, 9 January 2006.

³⁷ National Pensioners Convention, 2006, op cit.

³⁸ Brewin Dolphin Securities press release, 11 July 2005.

whilst for an average salary scheme it is 7%-8%, improving corporate profits by £4.15 billion a year, though this figure would increase as degradation of pension schemes accelerates. Another study estimated that in 2005, employees of the pension schemes in the largest 100 companies contributed on average 4.6% of their salary. In 2006, this rose to 5.2% and will continue to rise³⁹. In many cases, employers are paying an average of 7% of staff's pay into a money purchase scheme, which is about half the average paid into a final salary scheme⁴⁰. Some companies feel that despite all the upheavals they do not wish to abide by the rules. In 2005, the pensions regulator received over 400 allegations of pension rule breaches and is estimated to be dealing with 90 reports a month⁴¹. Employees could resist the dilution of their pension rights, but have too few rights to do so.

LACK OF EMPLOYEE RIGHTS

Some companies are offering bribes and financial incentives to employees to quit the agreed final salary pension scheme and take out personal pension plans⁴². Some companies have been very aggressive in promoting their transfer deals leading to fears of a repeat of the pensions mis-selling scandal. In the 1980s and early 1990s hundreds of thousands of investors were short-changed after being pressured into transferring from company schemes to personal pensions. Employees have few rights to resist degradation of their pension rights.

In March 2006, the UK's biggest insurance broker, Marsh (part of the US conglomerate Marsh & McLennan) sacked three employees for refusing to accept changes to their pension scheme⁴³. After consulting its 3,100 employees the company had changed its employee pensions scheme from a final salary scheme to a less generous "career revalued" scheme. However, three employees refused to accept the new scheme, which offered pension at age 65, based on accruing 1/60th of a member's salary each year during their career - rather than their salary in the final year of their career as in the old scheme. The legality of such moves is open to question. In 2003 the London law firm of Clyde & Co dismissed four members of staff, including a salaried partner, for refusing to accept new contracts that only gave them membership of a "money purchase" pension scheme rather than

³⁹ <http://news.bbc.co.uk/1/hi/business/5059242.stm>; accessed 8 June 2006.

⁴⁰ <http://news.bbc.co.uk/1/hi/business/5047716.stm>; accessed 6 June 2006.

⁴¹ The Guardian, 16 May 2006.

⁴² Sunday Times, 7 May 2006.

⁴³ <http://news.bbc.co.uk/1/hi/business/4753703.stm>; accessed 14 September 2006.

the former final salary version of which they had been members. The equity partners in the firm, who owned it and carried its financial risk, had been told that the final salary scheme they ran for the other staff had a deficit of nearly £8m. The firm would have to pay for this directly from the equity partners' own profits and claimed that the existence of this volatile liability would make it very hard to recruit new partners to the firm. The Employment Tribunal which heard the case decided that Clyde & Co had a "sound, good business reason" for the change. It rejected the claim of unfair dismissal.

FAT-CAT PENSIONS FOR COMPANY EXECUTIVES

Companies claim that increasing life expectancy, low interest rates, inflation rates, low bond and equity yields and a stagnant stock market makes it impossible to provide good pension schemes for employees. However, the same does not apply to company directors. While the average retirement age is 65 for men and 60 for women, nearly 8 out of 10 company bosses in Britain retire at 60 and on average receive a pension twenty-six times higher than the average worker⁴⁴. One study estimated that the average pension of a FTSE 100 director is £168,000 a year or more than £3,200 per week, whilst their workers picked up just £7,124 a year⁴⁵. Five directors have a pension pot of more than £12 million and growing.

In 2005, with pre-tax profits of over £8 billion, Royal Bank of Scotland (RBS) won plaudits by announcing that it would invest an additional £933 million into its final salary pension scheme. The euphoria was short-lived. In 2006 the company announced half-year profits of £4.5 billion and annual profits expected to hit over £9 billion. It closed its final salary scheme to new entrants.

Company accounts published in 2006 show that despite a 25% fall in profits, the chief executive of Rentokil picked up £2.1 million for nine months work together with £1.6 million worth of free shares, £500 a day contribution to his pension scheme and a chauffeur-driven car with a private use value of £42,000. The company announced 1700 redundancies and ended the final salary pension scheme for its employees.

At Philip Green's Arcadia Group, which owns Bhs, Top Shop, Dorothy Perkins, Wallis and Burton, 25,000 staff must increase pension contributions by half and work five years longer to qualify for the same

⁴⁴ The Guardian, 24 November 2005.

⁴⁵ Daily Mail, 6 September 2006.

payout. However, Arcadia paid out a dividend of £1.3 billion in 2005. Philip Green and his wife own 92% of the business and therefore received £1.17bn. The shares are held in the name of his wife who is resident in Monaco. The UK permits non-residents to receive dividends without any deduction of tax at source. So she did not have to pay the UK income tax of around £300 million, equivalent to the state pension of nearly 60,000 people. In 2006, Philip Green received a knighthood for 'services to the retail industry'⁴⁶.

Unilever claims to have a deficit of nearly £2.9 billion on its pension scheme. That did not preclude it from providing fat cat pensions for its directors. Its chief executive Niall FitzGerald retired after 37 years with a pension pot of £17 million and Unilever managed to find an extra £3 million to boost his pension pot. His starting pension is estimated to be over £850,000 each year, bigger than the wages that many people are likely to earn in their entire working life. Cats really love cream and always get it.

In 2005, Britain's last volume car maker MG Rover went into administration and subsequent closure with the direct loss of 6,000 jobs. A report by the House of Commons Public Accounts Committee⁴⁷ noted that the cost to the private sector and former employees of MG Rover's collapse may exceed £600 million, comprising an estimated deficit in the Company's pension scheme of £500m which may have to be met by the taxpayer funded Pension Protection Fund, and £109 million owed to UK-based trade creditors. In contrast, the four businessmen who formed the consortium to buy MG Rover for £10 in May 2000 made about £40 million out of the company. Many workers had been with the company for 15-20 years and would be fortunate to draw their full pension entitlement. The directors had amassed a pension pot of £17 million and expect to live in comparative luxury.

With a 30% share of the high street trade, Tesco is Britain's biggest supermarket. It had pre-tax profits of £1.9 billion and £2.2 billion for the years to February 2005 and 2006. In August 2006, it announced half year's profits of £1.1 billion and expects to make £2.6 billion for the full year. None of this could be achieved without the work of its employees whose average wage of £11,594 is certainly not enough to provide savings for pensions. Tesco chief executive collected £5 million and can expect to retire on annual pension of £546,000. The company claimed that it could

⁴⁶ The Observer, 18 June 2006.

⁴⁷ House of Commons Public Accounts Committee, (2006), *The Closure of MG Rover*, London, The Stationery Office.

not afford to continue with its final salary pension scheme and diluted it by moving most of its employees to a scheme where their pensions would be lower because they would be based on their career's average earnings.

In 2006, millionaire Mohamed Al-Fayed closed the final salary scheme for Harrods to existing and new staff, effectively halving the employer's contributions. The schemes had a deficit on £111 million. The accounts of the company to January 2005 show that Mohamed al-Fayed and his family received a dividend of £39 million. This is a 50% increase on the £27 million dividend for the year 2003, making a total of £113 million in the four years to 2004.

In early 2006, Debenhams was floated on the London stock market for £1.67 billion. Its chief executive, chairman and finance director shared a bonanza of £23 million. The reward for employees who helped build the company was a diluted pension scheme. The Co-operative group does not have a deficit on its pension scheme, but has changed the basis for payments on its pension scheme to an average salary system rather than linking it to final-year pay.

In September 2006, an investigation of the accounts of the FTSE100 company directors by *Labour Research* revealed⁴⁸ that on retirement, on average' they will receive 71 times the basic state pension for a married couple. A total of 112 FTSE 100 company directors are entitled to a pension worth at least £200,000 a year. Twenty-seven of them can expect a pension of at least £500,000 a year - the equivalent of £9,615 a week. Corporate boardrooms are an 'us' and 'them' world.

The survey also found that directors at pharmaceutical giant AstraZeneca can retire at 50. Directors of financial services provider Friends Provident and energy group BG can retire at 55 with no reduction in their pension. Over three-quarters (77) of the companies that make up the FTSE 100 index still have "final salary" schemes for their directors. These findings come at a time when many companies have been closing their final salary schemes to new employees or requiring employees to make higher contributions. The government wants employees to work until they drop.

Everywhere the fat-cats are helping themselves whilst imposing cuts on employees. Some of the fattest pension cats are shown in the table below.

⁴⁸ <http://www.lrd.org.uk/issue.php3?pagid=1&issueid=1066>; accessed 3 September 2006.

**TABLE 3
SOME FAT CAT PENSIONS**

Director	Company (Year End)	Annual Pension £000s
Lord Browne	BP (12.05)	991
Sir Francis Mackay	Compass (12.05)	830
Howard S Frank	Carnival (11.05)	795
John Sunderland (1)	Cadbury Schweppes (12.05)	762
Antony Burgmans	Unilever (12.05)	762
Lawrence Fish	Royal Bank of Scotland (12.05)	761
John Walsh (2)	BOC (9.05)	714
Michael Bailey	Compass (12.05)	648
Jeroen van der Veer	Royal Dutch Shell (12.05)	647
Sir Tom Mckillop	AstraZeneca (12.05)	639
Patrick Cescau	Unilever (12.05)	638
Todd Stitzer	Cadbury Schweppes (12.05)	623
Sir Julian Horn-Smith	Vodafone (3.06)	605
Dr Jean-Pierre Garnier	GlaxoSmithKline (12.05)	601
Michael Geoghegan	HSBC	557
Paul Walsh	Diageo (6.05)	556
James Crosby	HBOS (12.05)	553
Sir John Bond	HSBC (12.05)	546
Sir Terry Leahy	Tesco (2.06)	546
Keki Dadiseth (1)	Unilever (12.05)	542
Sir David Prosser	Legal & General (12.05)	537
Richard Harvey	Aviva (12.05)	527
Mike Turner	BAE Systems (12.05)	523
Dr John McAdam	ICI (12.05)	521
Ken Hydon	Vodafone (3.06)	517
Roger Urwin (1)	National Grid (3.06)	516
Rudy Markham	Unilever (12.05)	514

(1) Retired 2005
(2) Resigned 2005.

Source: Labour Research Department press release, 3 September 2006;
<http://www.lrd.org.uk/issue.php3?pagid=1&issueid=1066>

Summary and Discussion

Pension commitments are part of a legally binding employment contract between the employer and employee. A pension is effectively a deferred wage that employees will collect later in life. Responsible employers can make pension scheme deficits good over a period of time. Yet the government is unconcerned that too many are taking the easy option of closing the scheme to new entrants, closing it altogether, seeking higher payments from employees, or generally diluting the pension rights of scheme members. All this improves company profits, but erodes workers' retirement security and create new social problems. Employees have too few rights and are unable to resist the tide of pension scheme closures and dilutions.

Whilst diluting pensions for employees, companies have retained generous pension schemes for their executives. In many cases directors continue to collect generous pensions for modest and even negative performance. They retire early and enjoy the lifestyle that they have become accustomed to. Directors appoint chums to corporate remuneration committees and then sit on their committees. This way the chums continue to provide ever escalating benchmarks for each other. They also wheel out consultants to claim that fat cat pensions are needed to motivate directors and reward them for performance. However, the same arguments are not applied for the welfare of staff. Employees need to be rewarded too. Without the investment of brain, brawn, muscle, sweat and tears of employees no executive could ever generate wealth, but the pension debate shows that so many claims about 'corporate social responsibility' are hollow. Companies are focused on profits, less on people.

CHAPTER 4

MISERY FOR PENSIONERS

Poor public policy choices have condemned too many pensioners to a life of poverty, misery and hardship. Yet companies, their executives, the CBI and even ministers are busy telling us that we have been overpaying ourselves in pensions. So companies need to end good pension schemes. If that was ever the case today's pensioners should be enjoying a golden old age. They aren't. Compared to other western nations Britain pays low pensions and pensioners face a huge reduction in the quality of their life.

According to the Organisation of Economic Cooperation and Development (OECD)⁴⁹, in the league table of state pensions in 30 advanced industrialised nations Britain is ranked 26th when measured by the state pension as a proportion of average post-tax salary⁵⁰. Using an average UK salary of £22,000, the OECD reported that the average state payout, which itself masks many inequalities, can be up to 48%. For developed western countries the average is about 69% of pre-retirement earnings. The greatest payouts are in Luxembourg, equivalent to 102% of post-tax pay. Austria, Hungary, Italy, Spain and Turkey are also way above the UK with about 75% of post-tax pay. Countries, such as Greece, Portugal and the Czech Republic, though comparatively poor, provide better pensions. One of the reasons for low UK pension is that successive UK government have pushed people to make their own provisions, but the pension industry does not provide good returns. Without proper regulation and enforcement markets fail to deliver. The main reason for low state pensions is that in most other developed countries employers make higher national insurance contributions⁵¹ (NIC). In the UK, in general employers are required to pay 12.8% of employee earnings between £97 per week (£5,044 per annum) and £645 per week (£33,540 per annum). The employee pays at the rate of 11%. The ceiling ensures that the rich don't pay NIC on their entire income. The contribution by UK employers translates as approximately 9.6% of the labour cost. The equivalent figures for France, Italy, Belgium and Austria average at 29.7 %, 24.9%, 23.3% and 22.6% respectively.

⁴⁹ Organisation for Economic Co-operation and Development, (2005), *Pensions at a Glance: Public Policies across OECD Countries*, Geneva, OECD.

⁵⁰ http://www.financegates.com/news/world_news/2005-05-06/oecd_05062005.html; accessed 7 May 2006.

⁵¹ These are often known as "social security contributions" in other countries.

TABLE 4
NATIONAL INSURANCE CONTRIBUTIONS
AS % OF LABOUR COSTS

Country	Employee%	Employer %
France	9.6	29.7
Hungary	10.0	26.3
Czech Republic	9.3	25.9
Italy	6.9	24.9
Sweden	5.3	24.5
Spain	4.9	23.4
Belgium	10.7	23.3
Austria	14.0	22.6
Greece	12.5	21.9
Slovak Republic	10.6	20.8
Portugal	8.9	19.2
Finland	5.1	19.4
Turkey	12.3	17.7
Germany	17.3	17.3
Poland	21.3	17.0
Luxembourg	12.3	11.9
Norway	6.9	11.6
Japan	10.5	11.3
Canada	6.2	10.5
Switzerland	10.0	10.0
Ireland	4.7	9.7
United Kingdom	8.2	9.6
Netherlands	19.7	9.5
Unweighted Average		
OECD	8.8	15.2
EU – 15	10.0	17.8
EU – 19	10.6	18.8

Source: Adapted from Organisation for Economic Co-operation and Development, (2006). *Taxing Wages: 2004-2005*, Geneva, OECD.

UK Pensioners receive income from a variety of sources. These include the state pension, income from occupational pension schemes, investments, social security benefits, tax credits and earnings from employment. For the period April 2006 to April 2007, the state pension for a single pensioner is £84.25 per week (£4,381 per annum) and £134.75 per week (£7007 per

annum) for retired couples, assuming a full National Insurance contribution record. For those with insufficient contributions or other retirement income, the state provides a pension guarantee of means-tested credits to raise the income of a single pensioner to £114.05 per week and £174.05 a week for couples. Due to bureaucracy and confusion not all pensioners who are entitled to additional support actually claim it. Such support depends on contemporary fiscal conditions and can be eroded by political parties. Nearly 3.03 million individuals (2.5 million households) receive Pension Credits. Of that, over 2 million are women. The average weekly award was £42.42⁵². So the average pensioner income is inadequate to meet the exorbitant rises in council tax, energy, transport and other costs. Experts believe that an average person would survive only three days on the weekly state pension⁵³. Single women fare worst after trying to live on the payment, which leaves some pensioners choosing between heating and eating. Due to child bearing, child rearing, lack of employment opportunities and discrimination only 23% of UK women retiring at 60 qualify for the full basic state pension.

Government statistics published in March 2006⁵⁴ show that pensioners on average received £311 a week in gross income in 2004/5, which after deduction of direct taxes became £263 a week in net income. After taking account of housing costs, this translates into a mean of £239 per week and a median of £185 per week, i.e. half of all pensioners have income of less than £185 per week. Around 50% of this average gross income came from state benefits (including the state pension). Occupational pensions provided 27% of gross pensioner income and another 9% came from investment income. On average 9% of gross income came from earnings, although this is concentrated among a small group of pensioners.

The averages are distorted by regional, gender and ethnic differences and the fat cat pensions enjoyed by the select few. Nevertheless, thanks to pension credits, higher social security and other benefits, pensioner incomes have grown faster than average earnings across the economy as a whole over the last ten years. Net income for pensioners has grown in real terms by 31% since 1994/5, compared to real average earnings growth of about 16% over the same period. Net income after housing costs has grown more quickly, increasing by 45% in real terms since 1994/5, partly due to the fact that pensioners are now more likely to own their home than they

⁵² Department of Work and Pensions press release, 7 June 2004.

⁵³ Daily Mail, 14 September 2006.

⁵⁴ Pension Analysis Directorate, (2006), *The Pensioners' Income Series 2004/2005*, London, Department of Work and Pensions.

were in 1994/5, and so have lower housing costs. The overall position of pensioner incomes is shown in Table 5.

	1994/95	1997/98	1999/2000	2004/2005
All Pensioner Units				
Gross Income (£)	232	246	262	311
Of which:				
Benefits income	123	129	136	156
Occupational pension	58	65	68	84
Personal pension inc	3	4	5	10
Investment income	29	29	30	29
Earnings	18	18	20	29
Other income	1	2	2	3
Net income before Housing Costs				
Mean	200	212	224	263
Median	153	166	176	209
Net income after Housing Costs				
Mean	165	179	192	239
Median	120	135	144	185
Pensioner Couples				
Gross Income (£)	336	360	377	440
Of which:				
Benefits income	152	157	164	185
Occupational pension	96	107	108	132
Personal pension inc	6	8	11	18
Investment income	47	50	50	47
Earnings	35	36	41	53
Other income	1	2	2	4
Net income before Housing Costs				
Mean	286	305	318	365
Median	223	240	250	291
Net income after Housing Costs				
Mean	249	270	285	345
Median	192	208	222	271

	1994/95	1997/98	1999/2000	2004/2005
Single Pensioners				
Gross Income (£)	168	177	194	225
Of which:				
Benefits income	105	112	119	136
Occupational pension	34	39	44	51
Personal pension inc	1	1	2	5
Investment income	18	16	19	16
Earnings	8	8	9	13
Other income	1	1	2	3
Net income before Housing Costs				
Mean	147	156	169	195
Median	124	133	143	170
Net income after Housing Costs				
Mean	114	124	137	169
Median	83	94	107	138
Source: Adapted from Table 2.1, Pension Analysis Directorate, (2006), <i>The Pensioners' Income Series 2004/2005</i> , London, Department of Work and Pensions.				

The statistics mask some patterns. Pensioner poverty is particularly acute amongst women, who tend to have a low income⁵⁵. Many gave up work to support families, or due to gender discrimination were confined to low paid jobs. At the end of 2004, nearly twice as many female compared to male pensioners relied on means-tested benefits in retirement, with 1.2 million aged 60 and more receiving minimum income guarantee compared with 615,000 men. Persistent poverty is also concentrated amongst older women, with the proportion experiencing it three times that of the whole population. In 2003/4, single women pensioners had a median income of £141 per week whilst men had £164 per week. Women living in a couple had a median net individual income of just £77 compared with £199 for

⁵⁵ Falkingham, J., and Grundy, E., (2006), ESRC Seminar Series Mapping the Public Policy Landscape: *Demographic aspects of population ageing*, London, ESRC.

men. In private (occupational or personal) pension schemes, women are also disadvantaged. While 71 per cent of older men receive some private pension, only 43 per cent of older women do so, and among recipients, women's pensions are on average 53 per cent of their male counterparts

Around 1.4 million pensioners (14% of total) survive on £5,000 or less a year, which averages to just £3,000 per year or £8.49 a day after council tax, water and electricity bills⁵⁶. This struggle to live on £8.49 a day, could affect some people for 25 years of their lives. People make ends meet by searching for cheap food and second hand clothes, reducing heating costs and medication bills and not using telephone or transport to keep in touch with family and friends. 38% of pensioners have an income of £10,000 or less and more than 50% live on £15,000 or less annually

Black and minority ethnic pensioners are also more likely to be poor, with 29 per cent in households with incomes below 60 per cent of the median, compared with 19 per cent of older white people. Median net income before housing costs of pensioner households headed by someone from a White ethnic group was £204 per week in 2004/5 compared with £185 and £151 respectively for those headed by black and Asian pensioners.

Almost two million pensioners live in poverty – over half a million over-65s are undernourished and risk ill-health due to poor diet and in 2004-2005 more than 31,600 pensioners died from cold and related illnesses because they could not afford to adequately heat their homes⁵⁷. The situation is set to become worse as “only one in four private sector employees are now members of good employer pension schemes⁵⁸”.

The improved social security benefits since the late 1990s have helped to lift nearly one million pensioners out of poverty⁵⁹. However, around 2.5 million pensioners still live below the poverty line⁶⁰ (60% of median population income before housing costs) equivalent to £128 a week per pensioner in 2006. Around 5 million female pensioners, or 87%, do not

⁵⁶ Pension Age newslines, 17 June 2006;
<http://www.pensionsage.com/June%202006/June%20news/news170606.htm>

⁵⁷ Age Concern press release, 21 December 2004.

⁵⁸ Trade Union Congress press release, 28 December 2005.

⁵⁹ The Guardian, 10 March 2006.

⁶⁰ National Pensioners Convention, (2006), Real Security in Retirement: An Alternative Pensions System, London, NPC (<http://npcuk.org/briefings/NPC%20White%20Paper.pdf>).

qualify for a full basic state pension in their own right because due to career breaks they have been unable to make the national insurance contributions for the required qualifying 39 years.. Two-thirds of older people live on incomes of less than £150 a week, much less than the officially sanctioned figures for meeting basic necessities. The government's attempts to manage poverty and lower pensions by expanding the use of means-testing have failed to reach around 1.8 million eligible pensioners.

Many people who bought their house late in their working life are now stuck in debt with a never-ending mortgage. Scottish Widows Bank reported that almost two million pensioners have mortgage debts of more than £100,000. The average mortgage debt of 1.76 million pensioners is £45,300. One in three of these owe more than £50,000 and one in ten owes more than £100,000⁶¹. A debt service organisation reported⁶² that amongst those seeking advice, the over-60s had bigger liabilities than any other age group. With an average debt of £52,000 they owed more than three times the £15,000 owed by the under-30s. When pensioners are taken ill nearly half will need to sell their house to pay for nursing home care⁶³.

One in four pensioners is borrowing money to make ends meet, but debt holds particular dangers for pensioners on fixed incomes. The Consumer Credit Counselling Service reported that the amount of money owed by people over 60 has soared by 25% to an average of £33,658⁶⁴. One in seven considers equity release to clear off credit card and loan debts⁶⁵ even though this can create new financial problems. Prudential estimates that more than a million pensioners have an average debt of £15,500 and as many as 70,000 retirees have debts of between £50,000 and £75,000⁶⁶. The government statistics show that in 2005, 1.1 million men and women over the retirement age were working. These numbers increased by over 100,000 in the last year⁶⁷. Nearly half of people approaching retirement plan to remain in employment after reaching 65 and one in three people aged between 50 and 64 believe that the traditional retirement is a thing of the past. Indeed, 22% did not know whether after a lifetime of toil they

⁶¹ Daily Mail, 11 May 2006.

⁶² Daily Mail, 4 April 2006.

⁶³ The Times, 20 September 2006.

⁶⁴ <http://news.bbc.co.uk/1/hi/business/5104716.stm>; accessed 22 June 2006.

⁶⁵ <http://news.bbc.co.uk/1/hi/business/5346164.stm>; accessed 15 September 2006.

⁶⁶ Daily Mail, 26 July 2006.

⁶⁷ Daily Mail, 16 February 2006.

would ever be able to retire⁶⁸. For some working is a choice. Most must because they need to.

Summary and Discussion

Successive governments have condemned pensioners to poverty. The subtext of the current “can’t afford to pay pensions” debate is the assumption that the past pensions were so good they now cannot be maintained. There is no evidence of such a golden age of pensions. Despite comparatively high wealth the British state pension has always been poor. In recent years pensioner income has increased, but political parties are not committed to maintaining this or accelerating this growth on the grounds that there are too many pensioners for us to afford it. This results in means-testing of pension benefits which stigmatises the poor and ensures that many pensioners either do not or are unable to take up the benefits. Due to employment discrimination and lack of work opportunities many women will not be in a position to take out any effective personal pension plans. In common with poorly paid workers, the unemployed and migrant workers they cannot build a sizeable pension pot. A decent state pension can be the only reliable source of retirement income for them.

Low pensions condemn too many pensioners to poverty when thousands die each year because they cannot afford to heat their rooms and have to choose between cheap food, second-hand clothes and heating. Many have to borrow money to meet living and nursing homes costs. Yet the Turner report contains no recommendations about the plight of today’s pensioners. The only real answer is to immediately raise the state pension so that no pensioner receives less 60% of the median earnings. This would happen quickly if those who oppose it were forced to live for a month on the current state pension. The increased pensions would be funded by higher taxes for the rich, higher national insurance contributions by companies and a crackdown on organised tax avoidance that results in losses of billions of pounds of tax revenues each year.

⁶⁸ The Guardian, 12 July 2006

CHAPTER 5 INCOME AND WEALTH INEQUALITY

As the voting rights were extended to all adults, the propertied classes feared that universal suffrage would lead eventually to redistribution of wealth. Better pensions should have been the focus for such a process. They were never delivered to ordinary people. The public policy processes instead encouraged individualism, expecting people to make their own provision even when they lacked adequate income. The vested interests colonised public policymaking processes and think-tanks to stymie wealth redistribution. Successive governments pay lip-service but have never been prepared to face the cost of providing decent pensions. As the future number of pensioners and their plight grows, governments are even less keen to redistribute. The government's timorous proposals actually make the position worse because they do not deal with the fundamental causes of the pensions crisis. The result is that millions have not shared in the economic gains in recent years and don't have the resources for forced savings or pension contributions. Inequalities in the distribution of income and wealth have been institutionalised. Poor people are unable to save for retirement and continue to be condemned to poverty. Companies object to a decent minimum wage. The rich object to progressive taxation policies. So millions have no income security in retirement.

From 1979 to 1997, Thatcherism curbed public expenditure, social welfare and employee rights. It abandoned the link between state pension and earnings and persuaded many companies to close occupational pension schemes in favour of personal pensions. It showed no interest in curbing inequalities in the distribution of wealth and income. Britain is the world's fifth largest economy and a rich country, but the "gap between the highest-paid and the lowest-paid workers is greater than it has been for at least fifty years⁶⁹". By the late 1990s, the number of UK citizens living on less than half of the average income tripled. Black and Asian families are disproportionately in the poorest fifth of the income distribution⁷⁰. The "proportion of people in low incomes in absolute terms has remained roughly constant since 1979 despite average income growth of over 40 per cent⁷¹". As a result, millions of people simply do not have the resources to generate income for old-age or make investment in retirement plans.

⁶⁹ Giddens, A. (1998), *The Third Way: The Renewal of Social Democracy*, Polity Press, London, p. 105.

⁷⁰ UK Department of Social Security (1999), *Opportunity for All: Tackling Poverty and Social Exclusion*, The Stationery Office, London.

⁷¹ Department of Social Security, 1999, p. 27, op cit.

The official statistics show that the wealthiest 1% owned approximately 21% of the UK's marketable wealth in 2003. Half of the population has only 7% of total wealth.

TABLE 6
SHARE OF THE UK WEALTH
TOTAL MARKETABLE WEALTH

% of wealth owned by	1976	1986	1996	1999	2000	2001	2002	2003
Most wealthy 1%	21	18	20	23	23	22	24	21
Most wealthy 5%	38	36	40	43	44	42	45	40
Most wealthy 10%	50	50	52	55	56	54	57	53
Most wealthy 25%	71	73	74	75	75	72	75	72
Most wealthy 50%	92	90	93	94	95	94	94	93

Source: National Statistics, published on 8 May 2006, available on <http://www.statistics.gov.uk/cci/nugget.asp?id=2>

If the value of the dwelling is taken out of the above table, institutionalised inequalities become even starker and have become worse since 1976.

TABLE 7
SHARE OF THE UK WEALTH
MARKETABLE WEALTH LESS VALUE OF DWELLINGS

% of wealth owned by	1976	1986	1996	1999	2000	2001	2002	2003
Most wealthy 1%	29	25	26	34	33	34	37	34
Most wealthy 5%	47	46	49	59	58	58	62	58
Most wealthy 10%	57	58	63	72	73	72	74	71
Most wealthy 25%	73	75	81	87	89	88	87	85
Most wealthy 50%	88	89	94	97	98	98	98	99

Source: National Statistics, published on 8 May 2006, available on <http://www.statistics.gov.uk/cci/nugget.asp?id=2>

Since 1976, the top 1% of the population has got richer. It now owns 34% of the wealth. The top 50% have got richer still and own 99% of the wealth.

The share of the poorest 50% has declined to just 1% of wealth. 23% of the adult population has wealth of less than £5,000⁷². Nothing here enables people to provide for their pensions, or be optimistic about the future.

Unchecked Income Inequalities

Wealth distribution inequalities are indicative of deeper inequalities in the distribution of power, influence and income. Many companies take pride in reducing wages to employees whilst executive salaries are let rip. Governments just wring their hands, or blame globalisation, or the need to compete on low wages. A brief snapshot of recent years⁷³ is as follows:

- The poorest 10 per cent, and even the poorest 25 per cent, have benefited much less than the rest from the increase in prosperity over the last 20 years.
- During the 1980s, whilst median income rose by 28 per cent in real terms, that of the bottom quarter rose by only 15 per cent, and that of the bottom 10 per cent by only 6 per cent. In recent years, whilst the incomes of all have grown at a more equal rate, the gaps of the 1980s have not been closed.
- Relative to the majority of the population, many people – and in some cases whole neighbourhoods – have fallen further and further behind. Many millions of people are unable to afford goods and services that the majority deem necessary. Wider disadvantage associated with this increase in poverty, such as growing health inequalities and area deprivation have been well documented.

Source: Darton and Strelitz, 2003, p. 7.

Between 1997 and 2004, the average FTSE100 chief executive's total annual pay soared 80% from £955,000 to £1.7 million⁷⁴. During 2004, directors of major companies received an average salary increase of 18%. Ordinary workers received between 3% and 3.5% and barely kept pace with inflation⁷⁵. In some cases, company directors paid themselves over

⁷² http://www.hmrc.gov.uk/stats/personal_wealth/table13_5.xls

⁷³ Darton, D. and Strelitz, J., (2003). *Tackling UK poverty and disadvantage in the twenty-first century*, York, Joseph Rowntree Foundation.

⁷⁴ Daily Mail, 21 March 2005.

⁷⁵ <http://news.bbc.co.uk/1/hi/business/4405550.stm>; accessed 25 April 2006.

300 times the average employee salary in the same company⁷⁶. Non-executive directors received an average increase of 13%⁷⁷, with some getting 18%. Those at FTSE 350 companies are paid £40,000, while those at FTSE 100 companies earn an average £48,800. Some picked up £95,000 for just 25 days a year work, over four times the UK median salary. In 2004, tax recluse Lakshmi Mittal spent over £35 million on his daughter's wedding. In 2005, a City banker racked up a drinks bill of £36,000⁷⁸. In July 2001, six City slickers working for Barclays Capital ran up a restaurant bill of £44,007 for one meal⁷⁹. Even five years later, it takes an average worker nearly two years to earn this amount.

Organised greed and fat-cattery, both unabated bear no relationship to corporate performance. In 2005, FTSE100 directors pay rose by 28% compared to average earnings rise of 3.7%⁸⁰. According to KPMG's Survey of Directors' Compensation 2006⁸¹, the median take home pay of a FTSE 100 chief executive was £2.3m in 2005. Another survey⁸² noted that the total remuneration of a FTSE100 chief executive has risen to £2,864,282, equivalent to the average wage of about 127 workers. The figure includes salary, bonuses, share options and incentives, but exclude their pension pot. If included this would take their rewards to well over £3 million. FTSE 250 Chief Executives saw a nine percent median total remuneration increase to £878,000 and FTSE 350 saw an average salary of £350,000, up by £23,800⁸³. Despite the outlawing of gender discrimination under the Sex Discrimination Act 1975, full-time female workers on average earn 20% less than their male counterparts. For part-time female workers the gap increases to nearly 40%⁸⁴, condemning women to low wages, pensions and poverty.

In 1996/97, the average weekly income of UK employees was £343, rising to £408 by 2003/04. For the same period, median weekly income rose from £286 to £336, half the population had gross household income below £336 per week. In 2003/04, almost two-thirds of the population had incomes

⁷⁶ Sikka, P., Wearing, R. and Nayak, A. (1999), *No Accounting for Exploitation*, Association for Accountancy & Business Affairs, Basildon.

⁷⁷The Times, 16 October 2006.

⁷⁸ The Guardian, 1 October 2005.

⁷⁹ <http://news.bbc.co.uk/1/hi/business/1839963.stm>

⁸⁰ The Guardian, 3 October 2006.

⁸¹ KPMG press release dated 18 September 2006.

⁸² The Daily Telegraph, 24 September 2006.

⁸³ The Daily Telegraph, 2 October 2006.

⁸⁴ The Guardian, 29 December 2005.

below the national average income of £408 per week⁸⁵. The distribution is skewed by a relatively small number of people on high incomes. The Institute for Fiscal Studies notes that due to tax credits, the national minimum wage, child benefits and a variety of social security benefits the poorer households experienced greater income growth on average in 2003/04 than richer households. So income inequality has fallen for the third successive year, but remains slightly higher than in 1996/97. Despite a large package of redistributive measures, the net effect of Labour policies is to leave inequality effectively unchanged.

In 2004/05, almost two-thirds of the UK population had income below the national average of £427 per week, which translates as a median income of just £349 per week⁸⁶. One region had gross average income of just £253 per week. The government established poverty line (60% of median income) set at £210 a week (or £18,148 per annum) for a couple is meaningless when half the population has virtually no wealth. Government statistics show that the average weekly income of families in the top 10% is £658 a week or more. The bottom 10% averaged only £164 per week. The gross income (before taxes and benefits) of the top fifth of households in the UK was around sixteen times greater than that for the bottom fifth (£66,300 per household per year compared with £4,300)⁸⁷. After adjusting for taxes and benefits this ratio was reduced to four to one for final income, unchanged from previous years.

Since 1997 the top 10% of the population has secured a weekly increase in its income of £119 compared to only £28 for the lowest 10% of the population⁸⁸, barely adequate to enable people to provide food, shelter, clothing and education for themselves and their families. Yet rather than forcing companies to pay a decent wage and redistribute wealth, governments confine people to a cycle of poverty and then assuage that through cash benefits, such as Income Support, Child Benefit, and Incapacity Benefit, which go predominantly to households with lower incomes. Cash benefits make up 60 per cent of gross income for the poorest fifth of households and 36 per cent for the next group, falling to 2 per cent for the top fifth of households.

⁸⁵ Institute for Fiscal Studies, (2005), *Poverty and Inequality in Britain: 2005*, London, IFS.

⁸⁶ Institute for Fiscal Studies (2004), *A Survey of the UK Tax System*, Institute for Fiscal Studies, London.

⁸⁷ <http://www.statistics.gov.uk/cci/nugget.asp?id=334>; accessed 14 September 2006.

⁸⁸ The Daily Telegraph, 24 August 2005.

There is little change in the pattern of inequalities and insecurity. In October 2006 the Annual Survey of Hours and Earnings published by the Office of National Statistics⁸⁹, for the year ending April 2006, showed that the median gross annual earnings for full-time male workers is £25,800 (£25,100 in 2005) and £20,100 (£19,400 in 2005) for full-time female workers. There are huge regional variations. Gross weekly earnings are lowest in the north east, at £399, while in London the weekly wage is £572. Official statistics show that median earnings for all employees were £23,600 per annum (compared to £22,900 in 2005). 75% of all workers had a gross annual wage of less than £29,000. One study estimated that 60% of workers earn less than £20,000 a year and 80% less than £30,000⁹⁰. Top 10% had earnings of over £886 per week, while the bottom 10% earned less than £244 per week. Anyone striving for median income, but earning the national minimum wage of £5.35 would need to work for about 85 hours each week, leaving no time for family, education or decent healthcare. Many employees have to work overtime, or even take on additional part-time work to make ends meet. The proportion of full-time employees working overtime in 2005 was 23.9 per cent. Around 5.3 million workers, including home, migrant and temporary workers, earn below one third of the median hourly wage⁹¹.

Many shop, restaurant and clerical staff have annual income close to the minimum wage. The 2006 annual accounts of fashion retailer Next show that the company made pre-tax profits of £449 million, but its employees had an average annual salary of only £10,306. 368,000 employees at Tesco have an average wage of £11,594. In 2006, some 336,000 employees were earning less than the minimum wage⁹². 2,400 employers were investigated for failing to pay the minimum wage⁹³. Through prosecutions and persuasion the government recovered around £3 million from their employers. In 2006, some 150,000 workers were still being paid less than their entitlement of the minimum wage⁹⁴. Part-time employees, women, young people, mature workers and temporary workers are the most abused. From October 2006, for workers over the age of 22, the minimum wage is £5.35 per hour. The government has legalised discrimination against young workers by fixing the minimum wage of 18 to 21-year-olds at the rate of

⁸⁹ <http://www.statistics.gov.uk/pdffdir/ashe1006.pdf>

⁹⁰ The Guardian, 16 October 2006.

⁹¹ TUC press release, 9 September 2006.

⁹² <http://www.statistics.gov.uk/pdffdir/pay1006.pdf>

⁹³ Daily Mail, 22 December 2005.

⁹⁴ TUC press release, 10 September 2006

£4.45 per hour, while 16 and 17-year-olds are paid a minimum of £3.30 per hour. Ten of the worst excuses for not paying the National Minimum Wage (NMW) are as follows:

TOP TEN EXCUSES FOR NOT PAYING THE MINIMUM WAGE

10. I only took him on as a favour
9. The workers can't speak English
8. He's over 65, so the national minimum wage doesn't apply
7. She's on benefits - if you add those to her pay, it totals the NMW
6. They can't cope on their own and it's more than they would get in their own country
5. He's disabled
4. I didn't think it applied to small employers
3. I didn't think the workers were worth NMW
2. But she only wanted £3 an hour
1. He doesn't deserve it - he's a total waste of space

Source: HM Revenue & Customs press release dated 22 August 2006.

The poor receive some help from the state, but are also disproportionately affected by the regressive tax system. For the top fifth of households, indirect taxes (e.g. VAT) account for only 11 per cent of gross income, compared to 27 per cent for the bottom fifth. By redistributing wealth we can provide affordable pensions. However, in this age of reverse socialism such policies are rarely advocated. Instead, accountancy firms, lawyers, bankers and tax havens enable corporations and the rich to avoid and evade taxes on an unprecedented scale. The exact amounts are impossible to know, but a UK Treasury model estimated that the annual amounts could be between £97 and £150 billion each year, between 8% and 12% of the UK Gross Domestic Product⁹⁵, large enough to eliminate poverty, improve pensions and significantly improve the quality of life for all.

The tax relief on pension contributions is around £19 billion each year. Due to income inequalities “55 per cent of tax relief goes to the 2.5 million higher rate taxpayers who make up only around 10 per cent of taxpayers⁹⁶” and 13 million other workers share the remaining £9 billion. Someone earning £25,000 and paying 6 per cent into an occupational pension scheme

⁹⁵ The Sunday Times, 4 June 2006.

⁹⁶ Hansard, House of Commons Debates, 22 June 2006, col. 2029; Pensions Policy Institute, 2004, pp. 6-7.

would gain around £330 per year of tax relief; six and half times less than the amount given to a higher tax payer⁹⁷. Due to lack of income, part-time workers, those on minimum wage or those unable to enter a pension scheme, receive virtually no tax relief.

The UK tax regime advantages the rich. Under legislative rules introduced in April 2006, individuals can put their entire salary into their pension scheme, up to a limit of £215,000 a year. This does nothing for those on a low wage or unable to save for pensions, but will enable the well-off, paying a marginal tax rate of 40%, to claim tax relief of over £80,000. Rich individuals can build a pension pot of £1.5 million (which will rise with future rates of inflation) and claim tax relief on their pension contribution. Since most UK citizens will not earn that amount during their lifetime, the reform will not help the poor to have good pensions though fat cats will do nicely. Nearly nine out of 10 companies planned to give senior executives more share options to compensate for a legal cap on pension size⁹⁸.

Consequences of Inequality

Because successive governments have failed to reduce income inequalities millions are living on the edge and are in no position to save for retirement. Around 27% of people aged over 50 have virtually no liquid savings⁹⁹. 37% of the population as a whole does not have any money that it could readily access. Only 35% of women are able to save for a pension of their own¹⁰⁰ and 52% are unable to contribute anything. Those who do save make pension contributions of around £35 a month compared to £73 for men¹⁰¹. This will not provide a decent retirement income. Some 14% of men pay between £101 and £200 a month into a company or personal pension scheme, but only 5% of women can afford to do this. A single 30 year old female wishing to retire at 63 on a pension of £15,570 at 2006 prices would need to increase her average pension contributions from £35 to £200, or an increase of 600%, beyond the reach of most.

⁹⁷ <http://npcuk.org/briefings/NPC%20White%20Paper.pdf>

⁹⁸ <http://news.bbc.co.uk/1/hi/business/4629659.stm>; accessed 29 June 2005.

⁹⁹ Daily Mail, 11 March 2006.

¹⁰⁰ Daily Mail, 5 June 2006.

¹⁰¹ Daily Mail, 23 March 2006.

Scottish Widows UK Pension Report¹⁰² stated that the percentage of UK population saving adequately for retirement has fallen from 55% in 2005 to 46% in 2006, while the number unable to save for pensions rose from 17% in 2005 to 28% in 2006. This data shows that 4 in every 5 people who aren't relying on a final-salary pension are unable to save adequately for their retirement, and that 2 in 5 are saving nothing at all. These non-savers are most likely to be female, parents of young children, self-employed and those already in debts. Against a target saving average of 12% of earnings for a reasonable occupational pension, the savings ratio has fallen from 7.9% in 2005 to 5.8% in 2006. Because of their student loans and lifestyle choices, 25% of 18-34 year-olds would probably opt out of any other form of compulsory savings for pensions¹⁰³. Within a five year period, the proportion of 20 to 29 year-olds contributing to a private pension scheme has already fallen from one in three to one in four¹⁰⁴.

More than 12 million UK employees have no occupational pension and unskilled workers fare especially badly¹⁰⁵. The Financial Services Authority¹⁰⁶ found that 42% of adults are not in any pension scheme and 70% have no meaningful savings to see them through a sudden drop in income. Half a million households are in serious financial difficulty. Around one-quarter of adults aged 20 to 39 have fallen into financial difficulties. 24% of young adults are currently overdrawn, compared to 11% of over-50s and just 4% of over 60s. Some may be in this situation because of their lifestyles, but a large number lack adequate disposable income. The study reported that 81% of people of pre-retirement age think the state pension would not provide sufficiently for their old age. Yet four out of 10 people are not paying, or cannot pay into an occupational or personal pension to top up their state pension

Debt erodes the ability to contribute to pension schemes and Britain is the debt capital of the world. We are responsible for a third of all unsecured debt in Europe¹⁰⁷ and UK lending on credit cards, loans and overdrafts was

¹⁰² Scottish Widows, (2006), *Scottish Widows UK Pension Report: A major assessment of pension saving behaviour*, Edinburgh, Scottish Widows.

¹⁰³ The Guardian, 12 July 2006.

¹⁰⁴ Daily Telegraph, 12 July 2006.

¹⁰⁵ <http://news.bbc.co.uk/1/hi/business/2213295.stm>; accessed 28 April 2006.

¹⁰⁶ Financial Services Authority, (2006), *Financial Capability in the UK: Establishing a Baseline*, London, FSA.

¹⁰⁷ The Guardian, 27 September 2006.

£215 billion in 2005 compared to a total of £600 billion for the rest of Europe. On average Britons owe £3,175 compared to £1,558 for European counterparts. Such trends have been encouraged by government policies. Following the withdrawal of free university education many graduates have to obtain loans and part-time work to cover their fees and living expenses. It is estimated that on average university graduate will accumulate debts of £15,000, with no guarantee of a well-paid job. After graduation, the debt becomes payable once graduates start to earn in excess of £15,000 per annum. Coupled with income tax, national insurance contributions and the proposed 3% levy in the new pension scheme means that graduates, many in the 21-35 age group, could be paying tax at the marginal rate of nearly 48% of their income¹⁰⁸. Not much room then for pension contributions or even the necessities of life.

The average house price in the UK is now nearly £175,000, and even higher in London and the southeast. This is beyond the reach of the average citizen, requiring around seven years of average earnings just to get on the housing ladder. Where people can afford to buy a house, 20-40% of their after-tax income is taken up by mortgage repayments. Small wonder that the number of first-time house buyers is at a twenty-five-year low. Due to low income two million UK households now struggle to pay council tax each year¹⁰⁹. Since 2002/03, after taking account of mortgage payments, council tax and rising costs of water, gas, electricity and transport, a typical family with two children has seen its disposable income shrink by £82 a month. That leaves precious little to put away for pensions¹¹⁰. Many people are late in getting on the housing ladder and continue to pay loans and debts until later in life. People in the age group 40 to 59 owe an average of around £34,456¹¹¹.

Poverty is almost a crime. Poorer people can't expect help from banks. Indeed, 11% of UK adults do not have a bank account and in some poorer areas this rises to 35%¹¹². The poor find it difficult to get credit and pay more for goods and services. The energy prices have soared, but the poor pay even more because they need to prepay. Children living in poverty, disabled people and older consumers suffer most. They use prepaid meters

¹⁰⁸ Bosanquet, N., Gibbs, B., Cumming, S. and Haldenby, A., (2006), *Class of 2006: A lifebelt for the IPOD generation*, London, Reform.

¹⁰⁹ Joseph Rowntree Foundation press release, 28 September 2006.

¹¹⁰ The Guardian, 30 June 2006.

¹¹¹ <http://news.bbc.co.uk/1/hi/business/5104716.stm>; accessed 22 June 2006.

¹¹² New Economics Foundation press release, dated 6 March 2006.

and pay £173 a year more for gas and £113 more for electricity than customers who are billed quarterly¹¹³. Faced with difficulty disadvantaged customers are forced to disconnect because they do not have enough money to feed the meter.

Poverty also brings early death. Infant death rates for the poorest social groups are 19 per cent higher than for the total population. In 2001-03, six infant deaths per 1,000 live births were recorded among the least affluent, compared with 3.5 per 1,000 in professional and managerial groups¹¹⁴. In 2004/05, 2.4 million children were living in low income households¹¹⁵. Despite recent improvements, Britain has a poor record.

TABLE 8	
CHILD POVERTY LEAGUE	
COUNTRY	% of children living in relative poverty
Denmark	2.4
Finland	2.8
Norway	3.4
Sweden	4.2
Switzerland	6.8
Czech Republic	6.8
France	7.5
Belgium	7.7
Hungary	8.8
Luxembourg	9.1
Netherlands	9.8
Germany	10.2
Austria	10.2
Greece	12.4
Poland	12.7
Spain	13.3
Japan	14.3
Australia	14.7
Canada	14.9
UK	15.4
Portugal	15.6
Ireland	15.7
New Zealand	16.3

¹¹³ The Guardian, 4 September 2006.

¹¹⁴ Department of Health (2005), op cit.

¹¹⁵ <http://www.statistics.gov.uk/cci/nugget.asp?id=333>

Italy	16.6
USA	21.9
Mexico	27.7

Source: Adapted from Figure 1 in UNICEF, (2005), *Child Poverty in Rich Nations*, Florence, UNICEF.

Summary and Discussion

Many people would invest in pensions to provide for retirement income, if they had an adequate income. They don't. 50% of UK workers have a gross annual income of less than £23,000 a year, barely enough to provide food, shelter, education, healthcare and clothing.

In the face of this the proposals contained in the Government's White Paper cannot provide good pensions. The re-linking of the state pension to average earnings will increase pensioner income some years ahead, but it cannot address the key issues. The huge inequality in the distribution of income and wealth prevents many from making the required contributions to pension schemes. Many children are condemned to poverty and families have to rely upon borrowing, juggling credit cards or taking out never-ending loans at exorbitant rates, to make ends meet. Some still blame imprudence for poverty, but in most cases it is persistent and systemic. Simply chastising people to save more and pay into pension schemes won't work when people have to make hard choices between housing, food, transport, education and healthcare. The national minimum wage has raised the income of some, but it remains low. Many employers seem to begrudge even paying that. Companies want public subsidies but are not keen to pay democratically agreed taxes or higher national insurance contributions, which would finance higher pensions and alleviate pensioner poverty.

The regressive tax system makes this worse. For fear of upsetting corporations and the rich, successive governments have abandoned progressive taxation policies and have instead opted for indirect taxes (e.g. VAT). This erodes the disposable income of the poor and their ability to save for retirement. Governments claim to offer tax incentives for pension contribution, but most of the tax relief will go to a small minority of highly paid individuals. Reducing inequalities in the distribution of income and wealth is a necessary precondition of any durable pensions reform. Without this the government's proposals won't work.

CHAPTER 6

THE SHADOW OF CORPORATE INTERESTS

Successive governments preached the mantra of self-regulation and light-touch regulation to avoid a regulatory framework that punishes the plundering of retirement savings pension schemes. The Financial Services Authority only levies puny fines and shies away from taking effective action against insurance companies, or banks selling dud financial products. Yet billions of pounds of savings have vanished because employee pension schemes are controlled by companies. Directors and their appointees act as trustees. Conflicts of interests are inevitable as directors play a key role in devising the pension scheme rules, which contain provisions enabling directors to override the wishes of trustees, to pension scheme surpluses and abandon the deficits. As a result, employee retirement security is under constant threat.

Successive governments have encouraged ‘market’ solutions to pensions with the result that pension savings are invested in corporate securities rather than directly into real assets. Their value is always vulnerable to speculative bubbles. The proposed National Pension Savings Scheme (NPSS) would continue in the same vein by investing in global and UK equity and bonds and this is not accompanied by any reforms of the finance industry. Self-employed people can buy personal pension plans to generate income for retirement, but the finance industry has a history of mis-selling, high commissions and low returns. Retail financial services markets are characterised by severe asymmetries of information. Buyers cannot see, touch and feel the product. Most have little experience of the market and do not fully know the assumptions behind the product. Sellers always know more, but don’t share that knowledge with the consumer. They do not always train their staff properly and in many cases offer incentives to aggressively sell the product at any cost to the public.

THE CORPORATE CLUB

In 1991, millionaire Robert Maxwell committed suicide having stolen more than £400 million from his employees’ pension fund. His business empire had long been audited by Coopers & Lybrand (now part of PricewaterhouseCoopers). It “consistently agreed accounting treatments of transactions that served the interest of RM [Robert Maxwell] and not those of the trustees or the beneficiaries of the pension scheme, provided it could be justified by an interpretation of the letter of the relevant standards or

regulations”¹¹⁶. The firm’s senior partner told the audit team that “The first requirement is to continue to be at the beck and call of RM [Robert Maxwell], his sons and staff, appear when wanted and provide whatever is required¹¹⁷”. The accountants, lawyers and advisors working for Maxwell all made a lot of money, but many people lost out on pensions. No one has been effectively punished for this scandal. Coopers & Lybrand were fined £1.2 million by the accountancy profession, considerably less than the fees the firm collected from Maxwell, working out at about £2,000 for each of their partners and all went to the accountancy bodies rather than the victims of the frauds.

Major companies are estimated to have taken some £18 billion of pension holidays on the 1990s. They took pension holidays because the pension agreements were written by directors and permitted companies to take some or all of the surpluses, both processes were aided by the government. The Finance Act 1986 introduced a requirement that any pension scheme surplus should be reduced over a five year period by taxable repayments to the employer, benefit improvements or contribution holidays. Most companies chose pension holidays. In 1990 STC, an information systems company, had a pension scheme surplus of £270 million. The company suspended its pension contributions in 1989. The Financial Times commented “A surplus this big from a company with only 34,000 employees and 12,500 pensioners is good news, not bad: all the more so since the resulting contributions holiday not only saved £36m in 1989, but could stretch into the 21st century¹¹⁸”. In 1992, Molins (maker of packaging and cigarette rolling machinery) was eyeing its £90 million pension scheme surplus. This had already provided a £12.2 million fillip to Molins' results over the past four years¹¹⁹. Unilever¹²⁰, the maker of Wall's ice cream and Persil, enjoyed seven years of pension holidays and in 1999 it also swiped the fund's £270 million "surplus", adding it to Unilever's profits. Since 1992 it has stripped £1.2 billion from its fund. About two-thirds, £726m, was handed back to shareholders in the form of bigger dividends.

Pension scheme surpluses were also used in other ways. In November 1991, the trustees of the pension scheme operated by industrial

¹¹⁶ UK Department of Trade and Industry (2001), *Mirror Group Newspapers plc* (two volumes), The Stationery Office, London, p. 315

¹¹⁷ UK Department of Trade and Industry (2001), *op cit.*, p.367.

¹¹⁸ Accountancy, April 1990, p. 39.

¹¹⁹ The Independent, March 21, 1992.

¹²⁰ The Guardian, 10 July 2004.,

conglomerate Belling spent £5.5 million, 20% of the assets of the pension scheme, to buy one of its ailing subsidiaries¹²¹. A further £3.5 million was used to secure a refinancing package, which never took place though the fees paid to financial advisers, lawyers and accountants were irrecoverable. The company was placed into receivership in May 1992. Pension scheme members suffered substantial losses. The Burlington International Group was placed into receivership in March 1992¹²². Subsequently, it was discovered that of the £32 million gross assets of the employee pension scheme, £12.9 million (or 40%) were in employer-related investments. As the employer became insolvent, the realizable value of the investments was estimated to be only £3.2 million. The shortfall in the pension scheme reduced some people's pensions by 50%. The Lewis's Group¹²³ went into receivership in January 1991. The scheme's trustees had made an unsecured loan of £1.25 million to the company and paid £2.4 million to purchase a property from the employer which produced no income and was derelict. People think that with all the paraphernalia of audits, accountants and laws, pensions are safe, but they are wrong.

When the Conservative government sold-off the previously state owned industries cheaply¹²⁴, it also gave away pension scheme surpluses to buyers without adequate regard to legality or to the interests of pension scheme members¹²⁵. The privatised companies then used the pension scheme surpluses to pay for the inevitable redundancies that followed flotation and to pay high dividends. Paying redundancy costs out of profits was not a popular choice because many directors received salaries, bonuses and perks linked to published profits. The raid of pension schemes was an attractive option and the government obliged. The privatised companies also boosted profits, dividends and executive salaries by declaring 'pensions holidays' on the ground that the pension scheme had a surplus.

British Telecom's redundancy programme shed 29,000 workers in 1992 and effectively wiped out £913 million surplus from its pension scheme. BT employees did not have a pensions holiday, and contributed 6 per cent of their pay. However, from 1988 to the date of massive redundancies, the

¹²¹ Pension Law Review Committee, *Pension Law Reform: The Report of the Pension Law Review Committee (two volumes)*, London: HMSO, para 4.10.11.

¹²² Pension Law Review Committee, 1993, op cit., para 4.10.12.

¹²³ Pension Law Review Committee, 1993, op cit., para 4.10.13.

¹²⁴ The Times, 3 September 1998.

¹²⁵ National Audit Office, (1998), *Deficit in the Fund for Pensioners of the former Water Authorities*, London, The Stationery Office.

company did not make contributions to its pension scheme. The pension agreement had required the company to contribute 9 per cent of its employees' wages to the scheme. A company spokesman said that the 1992 wages bill was £3.963 billion, equalling annual holiday of roughly £357 million¹²⁶. Nuclear electric, another state-owned company used £70 million of the pension scheme surplus to fund redundancies¹²⁷. British Coal claimed that it was entitled to £470 million of the £1 billion pension scheme surplus. Unions claimed that the move was illegal. The corporation had already enjoyed a pensions contribution holiday until 1997 due to a previous surplus¹²⁸.

In 1986, the National Bus Company was privatised. At that time it had 14,000 vehicles, 55,000 staff and an annual profit of £22.8 million. It was split into 72 companies and sold-off between 1986 and 1988 for £324 million. The net receipts after cost and debt write-offs were only £89 million. A 1991 National Audit Office (NAO) report noted that the government sold early subsidiaries cheaper than the later ones. Not only were the assets undervalued and sold at a low price, the government took away the pension scheme surplus. After 13 years of litigation, in an out-of-court settlement, the government paid back £356 million¹²⁹.

In the early 1990s, the National Grid and National Power had large pension scheme surpluses. After privatization, the companies decided to make large-scale redundancies. Workers were enticed by enhanced pension benefits to take voluntary redundancies. Normally, such costs would be borne by the employers as lump sum payments, or additional payments into the pension scheme. In the case of National Grid, the pension scheme trustees recommended that half of the surplus should be used to improve pension benefits and the other half be used to reduce employers' pension contributions. However, the pension scheme agreement gave the employer the right to override the trustees' recommendations. It did and the company imposed a 70:30 recommendation in its favour. At National Power, with the agreement of the trustees, the company split the surplus 2:1 in its favour. In both cases, the trustees had the right to be consulted, but the ultimate decision was the employer's. Some were not happy with the pension scheme surplus being swiped by and litigation followed. The Pension Ombudsman felt that the action of the company was unlawful.

¹²⁶ Financial Times, 28 April 1993.

¹²⁷ The Independent, 5 February 1994.

¹²⁸ Financial Times, 5 April 1993.

¹²⁹ The Times, 16 June 1999; Financial Times, 31 July 1999.

This was subsequently overruled by the Court of Appeal¹³⁰, which felt that due to the wording of agreements, the surpluses could be used to reduce employer contributions and pay off debts owed to the scheme by the members. In the case of National Power, the court was not persuaded and felt that its interpretation of the arrangements was irregular. The Court felt that though the employers had an obligation to act in good faith owed to pension scheme members, this was not at a par with the obligations owed by a trustee, i.e. employers also had to think about their own and shareholders best interests and not solely about what is in the best interest of scheme members.

The dispute eventually went to the House of Lords¹³¹, which in 2001 ruled that National Power and National Grid did not have to return the estimated £1 billion surplus to the Electricity Supply Pension Scheme that grabbed between 1992 and 1995. Corporate advisers welcomed the decision saying the judgement “recognises the rights of a company which funds future pension promises in a prudent manner. While scheme members feel understandably protective toward the pension scheme's assets, it is usually right, in our view, that the sponsoring company should have some access to surplus assets, given that the company ultimately foots the bill in a final salary pension scheme¹³²”. Now pension schemes are in deficit the same sentiments are not voiced.

PRIVATE PROFIT BEFORE PEOPLE

The finance industry has a woeful record of care for its customers. Banks offer derisory interest rates on savings, but charge heavily for overdrafts and loans. Insurance companies push dubious products and encourage their staff to sell aggressively, making promises that are not met though fees and charges are collected just the same. The industry is concerned about maximising sales and private profits rather than the quality of its products, or care for customers. As a result, nearly “half the customers stopped

¹³⁰ *Jefferies and others v Mayes and others* High Court 10 June 1997 CH 1997-J-1348. Also see *The Times*, 11 February 1999, 25 February 1999.

¹³¹ Judgment on 4 April 2001- *International Power Plc v. Healy and Others, Formerly National Power v. Feldon and Others and National Grid Company Plc v. Mayes and Others* (available on <http://www.publications.parliament.uk/pa/ld200001/ldjudgmt/jd010404/ngrid-1.htm>)

¹³² Comment from actuarial firm of Barnett Waddingham; available on <http://www.barnett-waddingham.co.uk/cms/services/actuarial/news01064/viewDocument>

making regular contributions within four years¹³³”. It is hardly worthwhile looking for alternative products or suppliers as almost all companies in the financial services sector are mired in scandals.

Pensions

In the early 1980s, the Thatcher government persuaded many to come off state pension schemes and exercise ‘freedom of choice’ by purchasing their own personal pension plans. Employers were not necessarily obliged (despite the terms of many occupational pension scheme trust deeds) to make a financial contribution to pension schemes, but the government offered subsidy to encourage people to come out of the State Earnings Related Pensions Scheme (SERPS) and occupational schemes. The consumer magazine “Which?” estimates that 4.5 million people who contracted out of SERPS and into a personal pension will get less than they would have received had they stayed in the scheme. Since 1988, the government has handed over £35 billion of taxpayers' money to the pensions industry to invest on behalf of those people who were advised to opt into a personal pension. Of that, around £3 billion has been paid to pension providers and financial advisers in charges. Due to a combination of high charges and inappropriate products, the remaining amounts provided derisory returns¹³⁴. Banks and insurance companies went on a selling spree and wrongly advised people to come out of good company pension schemes. They were encouraged to buy expensive personal plans, generating high commissions for sellers, but leaving customers with worthless schemes. Some of the biggest financial names were involved in mis-selling. They have faced only puny fines, and even these are effectively passed on in costs to future investors and savers. Between 1988 and 1994, more than five million personal pensions were sold, often on the basis of misleading information. To date, over 99 per cent of consumers with mis-selling claims have received some compensation, estimated to be around £11 billion. Many claims are still pending and have not been satisfactorily resolved. Perhaps, up to 2.5 million people may have been fleeced¹³⁵ of up to £15 billion.

¹³³ The Times, 21 September 2006.

¹³⁴ http://www.which.co.uk/reports_and_campaigns/money/reports/pensions_and_retiring/Personal_pensions_news_557_70774.jsp; accessed 8 May 2006.

¹³⁵ Hansard, House of Lords Debates, 15 December 1998, col.1251.

Endowment Mortgages

In the 1980s and 1990s, the finance industry aggressively pushed endowment mortgages. High commissions and fees were made and investors were promised higher returns, partly influenced by the then higher interest rates. An endowment mortgage generally consists of two elements, an interest only mortgage and an investment (the endowment). The borrower makes regular payments to cover interest (which is not fixed) and a monthly premium for the endowment policy. The seller of the policy promises to invest the endowment premiums to repay the mortgage at the end of the defined term. Such policies also repay capital in the event of death.

But as these endowment policies matured, investors discovered problems. The maturity value of the policies was not sufficient to repay the mortgage, forcing people to find other resources to pay-off the mortgage. The tax savings were considered to be a major selling point for endowment policies, but these cannot be made without the necessary taxable income. Many investors did not have such incomes and could not afford to fund the policies for the designated period. The policies sold to them were not appropriate for their economic circumstances. This mis-selling of endowment mortgages generated income for corporations, dividends for shareholders and high executive remuneration, but for the consumer the promised income and capital value did not materialise. Around 16.7 million people can expect a shortfall of around £159 billion¹³⁶. By July 2006, the finance industry had paid out £2.2 billion in compensation, though the major test will come from 2012 onwards as many of the 25-30 years policies sold during the 1980s reach their maturity.

Precipice Bonds

Precipice bonds, also known as high income bonds, offered investors a return linked to a stock market index or indices, but their capital was not guaranteed. They were particularly targeted at retired people who were concerned by the falling interest rates and the decline in their investment income. The bonds promised high returns of 10% or more for periods of 3-5 years. Little information was provided about the risks and investors were not told that the returns depended upon investment in complex financial instruments, such as options, futures and swaps, which in essence are clever bets and gambles on the movement of share and commodity prices. The gamblers received handsome fees, charges and salaries, but with the

¹³⁶Daily Mail, 5 July 2005.

stock market downturn these clever bets did not pay-off. Most of the bonds became worthless. 500,000 people lost nearly £2.2 billion¹³⁷.

Personal Pensions

Many people have put their savings into a personal pension plan to supplement income from their state and occupational pension schemes. The returns are notoriously low and fees very high. As the money is invested in equity and bonds, fund managers are constantly shuffling money to get in or out of bonds and securities, which produces management fees that are not fixed or flat, but related to the value of the fund, even though that entails little or no extra work for fund managers. Around £330 billion is invested in personal pension plans and the pensions industry charges around £5 billion to manage this each year. That is equivalent to the state pension of 1.2 million pensioners.

Intelligent Money told the House of Commons Treasury Select Committee¹³⁸ that people are put off saving in personal pension funds because of the complicated and excessive charging system. Around £14 million is wiped off the value of UK personal pension plans every day in pension fund management charges. As a result, some 10 million consumers lose £5 billion a year. In 2005, savers (excluding employers' contributions, tax credits or contracted out payments) put £4.3 billion of new money into their personal pension plans, but the pensions industry took out £5 billion in fees. The total monies carried forward shrink as a result. Suppose a 30 year old person is fortunate enough to be able to put £200 a month into a personal plan. By the age of 65 they will have saved £84,000. However, the pension industry would have levied over £100,000 in charges and fees (based on a 1.5% annual fund charge) and the cumulative returns are low. As people get older the expectation is that their pension fund would grow and be at its largest. Precisely, at that stage the fees and charges are at their highest.

No Pension for Spouse

An estimated 140,000 personal pension plans sold before 1988 contain a clause stating that if the main beneficiary dies before taking the pension then his/her spouse or partner will only get the contributions paid in rather

¹³⁷ The Guardian, 27 November 2004.

¹³⁸ House of Commons Treasury Select Committee, (2006), *The design of the National Pension Savings Scheme and the role of financial services regulation* (2 Volumes), London, The Stationery Office, Vol. 2, p. 45.

than the full pension¹³⁹. Thus if the main policyholder dies prematurely, the surviving spouse or partner will be thousands of pounds worse off. One person found that his wife's pension would have paid out just a fifth of the full value if she died before cashing them in. In another case, a construction worker paid into the scheme for twenty years, but died before taking his pension, estimated to have a total value of £390,000. Because he died between leaving and taking his pension, his widow only received the premiums paid in, a total just £31,000 - less than ten per cent of the pension pot accumulated over twenty years. Not everyone reads and understands all the small print in insurance policies. The products do not carry any health warning. If they did people would not so easily be conned. The regulator, the Financial Services Authority (FSA), barks too late and rarely bites,

Split Capital Investment Trusts

The finance industry regularly develops new financial products to sell to an unsuspecting public without adequate testing, as once again shown by the Split Capital Investment Trust (SCIT) scandal. Prior to it, the government had appeased the corporate sector by ensuring that the FSA did not have regulatory powers over investment trusts. This set the stage for scandals.

Conventional investment trusts generally invest in just one type of investment or share and exist in perpetuity. Investors receive dividends and hopefully capital growth. In contrast, SCITs invested in a variety of portfolios and issued more than one type of share. They also had a winding-up date. So an investor seeking income opted for shares offering dividends and those seeking capital growth could opt for zero dividend but capital growth. At the date of winding up, those holding capital growth shares are paid first. The others rank after them.

Splits expanded highly in the period 1998-2002. A major problem with SCITs was that some had borrowed money to create the portfolios and then sold the shares in those portfolios. Many started during the dotcom boom, when market prices were high. SCITs also held shares in each other, thus multiplying the risks of investment because in the event of one failing there would be a severe knock-on effect. When stock-markets declined after the dotcom crash, many found themselves in difficulties and became insolvent. This need to pay-off loans meant that few funds were available to pay off other investors. Between 2000 and 2002, around 32 splits with zeros were suspended, or were in significant trouble, with an estimated loss for the

¹³⁹ <http://news.bbc.co.uk/1/hi/programmes/moneybox/4634670.stm>;
accessed 22 January 2006.

zero holders of £667 million, out of a total £785 million invested. Some 50,000 investors may have been affected and eventual losses may be £770 million. A report by the House of Commons Treasury Select Committee¹⁴⁰ said that “board members themselves, some trust fund managers and some sponsoring brokers—did not bring the true nature of the risks in zeros to the attention of the wider investment community” It added that a number of people in the industry "may have been involved in serious wrongdoing". The report concluded, "We have been left in little doubt that there is substance in the suggestions that there was some form of magic circle operating in a manner harmful to the interests of shareholders". In March 2006, some £115 million was paid out in compensation¹⁴¹, shattering the retirement security of many.

Payment Protection Insurance

People with debts have been persuaded to take out payment protection insurance (PPI) in the hope that the policy will cover them for the eventuality of unemployment, sickness or incapacity. However, banks having lured customers by offering what they called ‘cheap loans’ then hit them with expensive PPI policies as part of the financial package. PPI is estimated to generate annual premiums of £5.4 billion for banks. Out of this, £4 billion is pure profit and PPI bears little relationship to any kind of insurance. Some banks charge up to 600% more for PPI deals than comparable cover through other products. Some had offered staff bonuses for selling PPI¹⁴² even though the PPI policies do not cover indefinite payments and are inappropriate for many.

Playing with Pension Savings

The Equitable Life debacle is part of the huge problem with returns that are promised but not delivered. Too many companies sell pension plans and other savings policies, and then slash the bonuses and returns. None of this leads to reductions in fat-cat salaries, bonuses or pensions. Directors and managers collect fees regardless of whether these savings schemes perform.

¹⁴⁰ House of Commons Treasury Committee, (2003), *Split Capital Investment Trusts*, London, The Stationery Office.

¹⁴¹ The Guardian, 29 March 2006.

¹⁴² Daily Mail, 11 September 2006.

Moneyfacts reported¹⁴³ that pension payouts have crashed by up to three quarters in the last ten years. This will inevitably hit the retirement hopes of millions of people. Falling interest and investment rates, declining stock markets, poor investment decisions and high management charges have all combined to erode income. Someone putting £500 a year into their pension plan over 25 years might have expected to retire on an annual income of £13,695 a decade ago. Today the same savings would provide an annual income of just £3,841. An investment of £500 a year over 20 years would have given an income of £7,015 a year to someone retiring ten years ago. In 2006, it would be just £1,795 - a fall of 74.4%.

Rather than changing their investment policies and shifting investment from speculative stocks and shares into real assets (schools, hospitals, public transport) pension fund managers busily place bets on movements of interest rates, prices of commodities, futures, options, currency swaps and hedges. All are far more volatile than the stock market. Insurance companies and pension funds are piling into more exotic and complex financial investments. In the second quarter of 2006 alone, some £11.2 billion has been placed into these investments¹⁴⁴. In September 2006, Hermes, a major institutional investor, switched around £3 billion of its money from investment in BT equity to more speculative investments such as hedge funds, derivatives and private equity¹⁴⁵. Warren Buffett famously described derivatives as “weapons of mass financial destruction” because depending upon future uncertain events their value can range from zero to several millions. Despite this hedge funds are poorly regulated and can lose large sums of money if they do not correctly guess the direction of the markets. Recently a US hedge fund incorrectly placed bets that the price of oil and gas would continue to rise. In late September 2006, it actually fell, leaving the hedge fund with an estimated loss of US\$6 billion¹⁴⁶. In 1998, another hedge fund, Long Term Capital Management (LTCM), also placed clever bets to earn higher returns and failed disastrously losing US\$4 billion in just four months¹⁴⁷. Its directors included Myron Scholes and Robert C Merton who shared the 1997 Nobel Prize in economics and are credited with developing the Option Pricing Theory, which has become the bible of all speculative dealers. Even these Nobel Prize winners could not

¹⁴³ Daily Mail, 20 September 2006.

¹⁴⁴ <http://www.statistics.gov.uk/pdffdir/iipt0906.pdf>; accessed 27 September 2006.

¹⁴⁵ Financial Times, 16 September 2006.

¹⁴⁶ The Times, 27 September 2006.

¹⁴⁷ Dunbar, N., (2001). *Inventing Money: The story of Long-Term Capital Management and the legends behind it*. New York, John Wiley.

successfully guess the direction of the markets. LTCM collapsed and had to be rescued by the US taxpayer. Yet pension savings continue to be used to play financial poker. If the bets pay-off, the gamblers will pick up high fees, salaries and bonuses. If they don't the pension scheme members bear 100% of the losses.

Summary and Discussion

Despite reforms company directors are able to control pension schemes. Members are not allowed to elect directors, appoint auditors, receive company accounts, or attend annual general meetings to raise questions about the stewardship of their pensions. In such a vacuum, pension monies are not safe.

Organised looting by the finance industry has discouraged many people from saving or investing in financial products. Cigarettes carry health warnings. Food products carry information about possible harmful content. No such warnings or explanations accompany financial products. So the public continues to be taken for an expensive ride. Toothless regulators occasionally bark but rarely bite. In 2003, the Financial Services Authority (FSA) finally fined Legal & General £1.1 million for alleged mis-selling of with-profits endowment policies between January 1997 and December 1999 to 41,000 customers. The company successfully challenged the penalty on the ground of defective investigations and it was reduced to £575,000. In this first major challenge by a large company the regulators were found wanting¹⁴⁸. Rather than investing in real assets, many pension funds are now gambling people's savings on clever bets on the price of gas, electricity, commodities and risky investments. If they pay off the gamblers will collect large rewards. If they fail the employees face more misery.

¹⁴⁸ Financial Services Authority press release dated 27 May 2005.

CHAPTER 7

SUMMARY AND DISCUSSION

Britain is in a position to pay a decent pension to its citizens. It is the world's fifth largest economy and by world standards a rich country. Yet due to a series of poor public policy choices current pensioners are poor and perspective pensioners face a life of hardship and poverty. In addition to making their national insurance contributions, many workers have trustingly contributed to their company or private pension schemes only to find that their pension rights have been eroded. After making their agreed contributions, many find that retirement security has been stolen from them. Using the grudging state to enable people to live at or above the poverty line is no substitute for a decent and dignified living standard related to the wealth of the nation.

The pensions crisis is the inevitable result of poor public policy choices that institutionalise inequalities. The pension prospects of its victims can only be improved by reducing inequalities in the distribution of wealth and income. Yet governments have shied away from their duty. Gender and racial discrimination in employment and earnings persists and this translates itself into low pensions and poverty in retirement. The social inequalities continue to widen as fat-cats take larger shares of income and wealth. The vast majority of workers get a dirty deal and are not in any position to fund a good pension provision. It is the duty of government to remedy all this, but it has done very little. Successive governments have been unwilling to redistribute wealth through higher taxes for the rich, or even effectively tackling the tax avoidance industry operated by accountants, lawyers, bankers and financiers, which results in annual tax loss of between £97 billion and £150 billion. The erosion of hard won social welfare rights, regressive taxation policies, graduate debt, low wages and the looting of people's savings by companies has reduced people's ability to save for pensions.

A Labour government has the responsibility to regulate and protect people's savings and pensions. Yet its lightweight approach has failed to discipline the finance industry and protect savings. The pension savings are not directly invested in real assets. Thus their value is always vulnerable to speculative frenzies and stock market bubbles. Transtec, Versailles, Resort Hotels, Enron, Hollinger, WorldCom, Parmalat, MG Rover, Mayflower, Barings, Equitable Life, Independent Insurance and other episodes have all eroded pension savings. The investment of savings in the stock market benefits bankers, financiers and stockbrokers because they always receive commissions whether the securities are bought or sold, or make profits or

losses. Pension fund managers receive lucrative financial rewards for short-term gains, but escape accountability when the gambles don't pay off.

In a democratic and fair society governments, particularly Labour governments, should be dedicated to an equitable distribution of wealth. They are not. The ministers no longer talk about citizenship rights, justice or fairness. Instead they claim to be dedicated to consumer rights and choices. Those without the required financial resources are either disenfranchised or encouraged to blame their misfortunes on profligacy, the lack of hard work and foresight, not the poor public policy choices, or the fiddles of corporations and their advisers. Political ideology promises equality and democracy, but cannot deliver either as despite hard work and heavy taxes many people will remain confined to old-age poverty.

The political system has been captured by the highest bidders. Beyond the organised ritual of the periodic casting of the votes at elections, there is little democracy. A political party is replaced by another and little is done to erode inequalities. There is little debate about the underlying causes of poverty and low pensions. Rather than giving people control over how company profits and pension scheme surpluses could be used, governments defer to the powerful vested interests. The absence of effective regulation, rights and enforcement leads to pensions and mis-selling scandals as companies compete with each other to sell dud policies and collect the highest profits. Company executives collect high salaries and bonuses, but people lose their pensions. Responsibility for the organised looting is rarely accepted.

Proposed Reforms

The Turner report has no proposals for improving the income of today's pensioners. Even for future pensioners, it neglects the key issues, which are redistribution of wealth, progressive taxation policies, penalties on employers who violate the pension agreements and bringing the financial industry under democratic control. Without this there can no durable pension reforms because many people simply won't have the resources to contribute to the proposed second pension, or even receive a decent basic state pension. If they took out personal pension plans, evidence shows that they will not get good returns because the finance industry fiddles their savings. Due to inequalities, many women, migrant workers, the disabled, the unemployed, self-employed and low-paid workers are not in a position to make the contributions for the proposed second or a personal pension plan. For them and most of the population a decent state pension is

absolutely essential. The only answer is a fundamental rethink based on principles outlined here. These are:

1. A much more generous and universal state pension linked to the increase in earnings, so that retired citizens can share in the economic prosperity of the country.
2. This is to be financed by cracking down on organised tax avoidance schemes and tax havens. All income and profits made in the UK should be taxed in the UK, regardless of where the companies book them.
3. Redistribution by progressive taxation of wealth and income, higher national insurance contributions for companies and a small Tobin Tax on speculative investments in the stock markets.
4. Effective independent regulation of pension schemes, pension funds and the finance industry to ensure that the rights of pension scheme members are paramount and people's savings cannot be stolen from them.

There can be no escape from these fundamental propositions as a decent pension is absolutely vital for all. To achieve this Labour government has to be Labour and act in the interest of the people it represents, rather than cosy up to the narrow selfish interests of corporate barons. Only effective redistribution, regulation and enforcement will check the inbuilt tendencies to impoverish people and deny them good pensions.

The above principles should be translated into the following effective reforms.

1. The state pension is absolutely essential. At the very least this should equal 60% of the median earnings and should rise in line with the rise in average earnings. Depending upon their economic circumstances, people can supplement it through occupational and/or personal pension plans.
2. The state pension should be immediately raised to £114 per week for single pensioners and for £175 per week for couples and linked to the rise in earnings, so that people do not have to go through the indignity of means-testing or suffer because they do not understand the bureaucratic forms and procedures.
3. The higher state pension should be funded through progressive taxation policies. Many rich people living in Britain benefit from social infrastructure, but pay little or no income tax. It is estimated that some 65,000 people, including millionaires are not fully taxed in Britain. 16,000 of them declared foreign earnings of £800m in 2002

- on which they paid no tax¹⁴⁹. They should be subjected to the same tax rules that apply to millions of Britons.
4. As part of a programme of redistribution by higher taxation of wealth, those with annual income of over £100,000 should be expected to pay higher taxes at a marginal rate of 50%.
 5. Improved state pension can be funded by cracking down on tax avoidance. Britain is losing tax revenues of between £97 billion and £150 billion each year. Many companies avoid taxes through clever schemes devised and sold by accountants. Many make their profits in the UK, but pretend on be located in tax havens¹⁵⁰. Most such arrangements are a sham and have no economic substance. Organised tax dodging accounts for between 8% and 12% of the UK GDP and far exceeds the amounts spent on state pensions.
 6. UK companies are some of the most profitable companies in the world. They receive generous subsidies, tax sweeteners and grants from the public purse. The average profitability of non-financial UK sector is at a record high of 14.7%, with the services sector achieving 20.1% and oil and gas sector at 38.7%. Corporate taxes have also been reduced. It is now levied at 30% rather than at 52%. The actual corporate tax take now accounts for around 3% of the GDP. Some of the benefits of these extra profits should be used to finance good pensions. The employers' national insurance contributions should be increased. Currently, they form about 9.6% of the UK labour cost compared to an average of 15.2% for the OECD countries and 17.8% for the EU though in France, Italy, Belgium and Austria, they rise to 29.7%, 24.9%, 23.3% and 22.6% respectively. UK companies should share some of their profits with the public and should pay higher national insurance contributions.
 7. The upper limit of the national insurance contributions should be increased to raise extra revenue. Someone on £20,000 annual wage can expect to pay 8.25% of their wage in national insurance contributions compared to 9.1% for £30,000 wage, but due to an artificial ceiling someone on £100,000 wage only averages at 3.1%, and a person on £300,000 pays around 1%.
 8. A large amount of pension savings are gambled on the stock market. This generates huge fees for speculators. A modest Tobin Tax should be levied on all stock market activity to finance good pensions.
 9. Tax relief on pension contributions should be confined to the basic rate of income tax. So higher income earners will not continue to

¹⁴⁹ The Independent, 28 October 2004.

¹⁵⁰ Murphy, R., (2006), *Mind the Gap*, London, Tax Justice Network.

- receive 40% savings on pension contributions. The resulting savings can be used to improve the state pension.
10. The National Minimum wage should be raised so that people can afford to have a higher living standard and save for their pensions. Managing poverty through social security benefits, which can easily be replaced by a decent living wage so that employers bear the full cost of labour.
 11. Those on low wages pay income tax, national insurance contributions, council tax and indirect taxes, reducing their disposable income. People on minimum wage should be exempt from paying income tax and national insurance contributions, which can account for 10% of the income. Personal allowances for income tax should be equivalent to the annual minimum wage. The rich would also benefit from this, but tax lost can be clawed back by adjusting the higher rate thresholds.
 12. Inequalities in the distribution of income and wealth should be reduced by establishing links between the income of workers and company executives. Without the effort of workers no wealth can be generated. They should receive an equitable share of the wealth. No director should receive more than ten times the average wage in the same company, ensuring that extra rewards for directors lead to better rewards for employees as well.
 13. Major companies should be required to publish the highest and the lowest wages paid by the company, together with the number of workers on minimum provision and the ratio between top and bottom. The gap between the average male and female earnings and the steps taken to reduce it should also be disclosed.
 14. Companies should be forbidden from taking 'pensions holidays' as these reduce the investment in pension schemes and should be required to make good the pension holidays taken in the past. When companies issue free shares and share options to company executives they should be required to issue them to pension schemes as well so that the deficits can be reduced.
 15. Details and minutes of all meetings between company executives and pension scheme trustees should be publicly available. Pension scheme members' 'right to know' should take priority over corporate secrecy and confidentiality.
 16. Instead of paying corporations under the current Private Finance Initiative (PFI), to build public assets for high profits, the government should ask pension funds to directly finance hospitals, schools and roads and then lease them to the government in return

for income¹⁵¹, This would eliminate middle-men, excessive profits for banks, accountants and PFI companies and at the same time ensure that the pension scheme deficits are eliminated.

17. Too many people have suffered from mis-selling by banks and insurance companies. They continue to devise new schemes with enticing promises, but then fail to deliver. To check mis-selling, the Financial Services Authority should test all financial products before launch, with the results publicly available. All financial products should carry appropriate warnings and it should be an offence to sell any unauthorised financial product.
18. Pension scheme members should elect company directors and auditors, have the right to receive annual company accounts, attend annual general meetings and ask questions about the stewardship of their pension schemes.
19. To ensure that directors accept full responsibility they must personally certify all published company financial and non-financial statements and be personally liable for fraudulent or misleading statements. Personal certification of company reports should be a necessary condition for listing on the stock exchange. The same should also apply to auditors. Defrauding employees and pension scheme members should lead to mandatory sentences of 10 years in prison with appropriate fines.
20. Poorly paid workers will always find it hard to supplement their state pension. The government has not made a convincing case for the second pension, but if it wishes to pursue this for low paid workers a 'matched-funding approach' is needed. The 4% employer contribution proposed in the government White Paper on pensions should be matched by a 4% contribution from the government. The cost can be met by restricting pension contribution tax relief to the basic rate of income tax only, crackdown on tax avoidance and progressive taxation policies.

This list is neither comprehensive nor exhaustive, but these policies need to be implemented by any government with a genuine determination to solve the pension crisis and provide better pensions and a fairer society.

¹⁵¹ Murphy, R., Hines, C., and Simpson, A., (2003). *People's Pensions: New Thinking for the 21st Century*, London, New Economics Foundation.

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PENSIONS CRISIS: A FAILURE OF PUBLIC POLICYMAKING

argues that the current pensions crisis is due to a series of poor public policy choices. Successive governments have failed to reduce inequalities in the distribution of income and wealth. They have financed tax cuts and reduction in public expenditure by reducing the state pension. Regressive taxation policies have reduced people's ability to invest and supplement their pensions. Too many people are surviving on the edge and lack adequate disposable income to make savings for retirement. Many women, ethnic minorities, self-employed, disabled, the unemployed, part-time workers and families with young children are unable to make provision for retirement.

Companies have been permitted to take 'pension holidays' and also swipe pension scheme surpluses to increase corporate profits. Now too many are closing good pension schemes or diluting employee rights. Some people have sought to supplement their state pension by investing in personal pension plans, but the finance industry sold dud products and millions of people have lost their savings. Without addressing the above issues there can be no durable solution to the pensions crisis. The monograph calls for decent state pension finance through redistribution of wealth. It urges a crackdown on organised tax avoidance, higher national insurance contributions by companies, higher taxation for the rich and effective regulation of the finance industry.

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