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Why are incentives to work and save important?

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Pensions Policy Institute

Part of the *Shaping a Stable Pensions Solution* series of seminars

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www.pensionspolicyinstitute.org.uk

The problem

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More money has to go towards paying for retirement income than used to be the case, as:

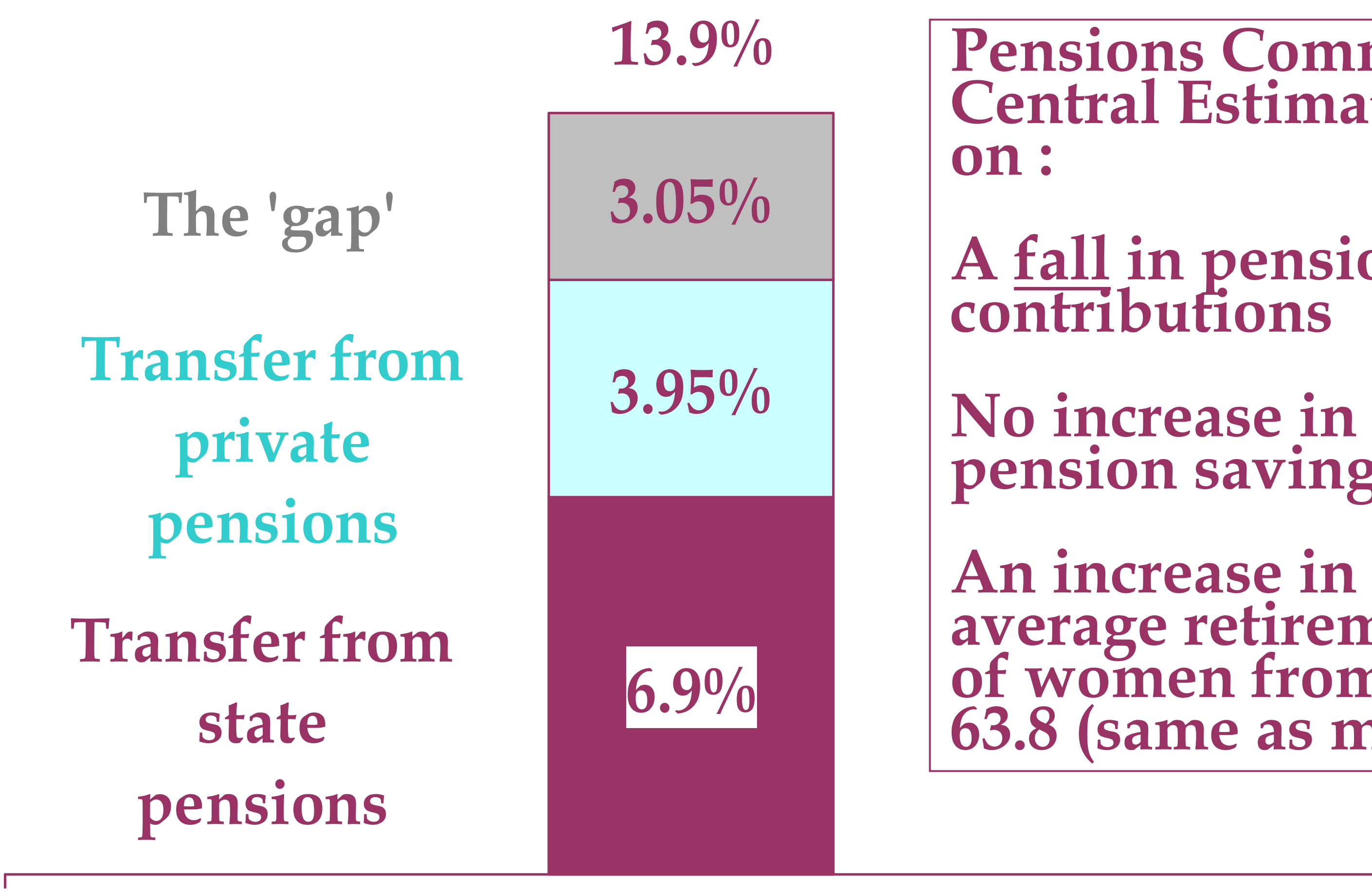
- We are living longer
- Future investment returns are expected to be lower than historic
- State pensions are declining

BUT

- Contributions to private pensions are at best flat
- We do not know the impact of more non-pension saving and working longer

How big is the ‘gap’?

Projected proportion of GDP transferred to pensioners to maintain average pensioner living standards, 2050



Pensions Commission Central Estimate, based on :

A fall in pension contributions

No increase in non-pension saving

An increase in the average retirement age of women from 61.6 to 63.8 (same as men now)

A combination of level saving and working longer can close the 'gap'

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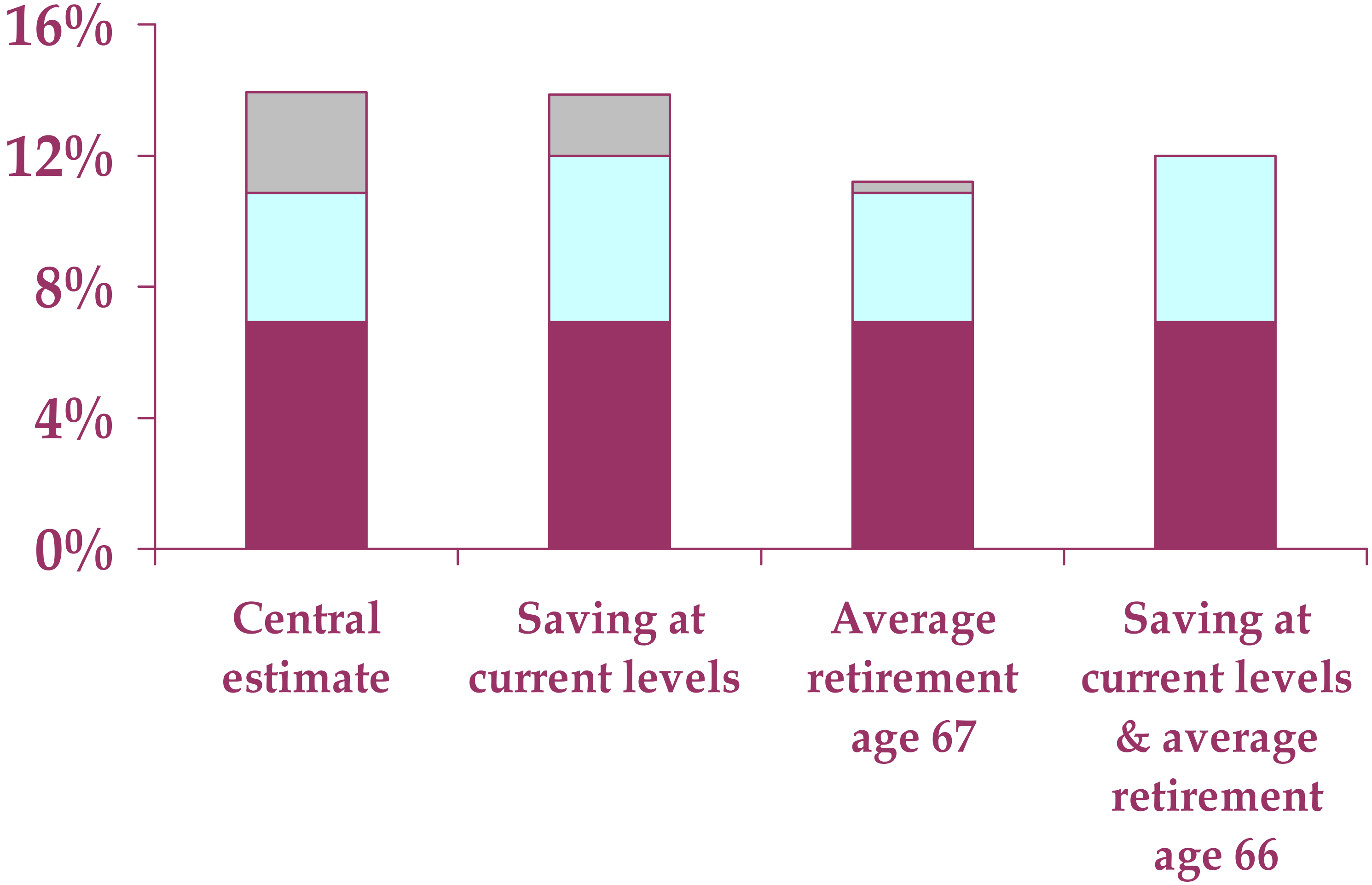

Higher state spending and working longer can close the 'gap'

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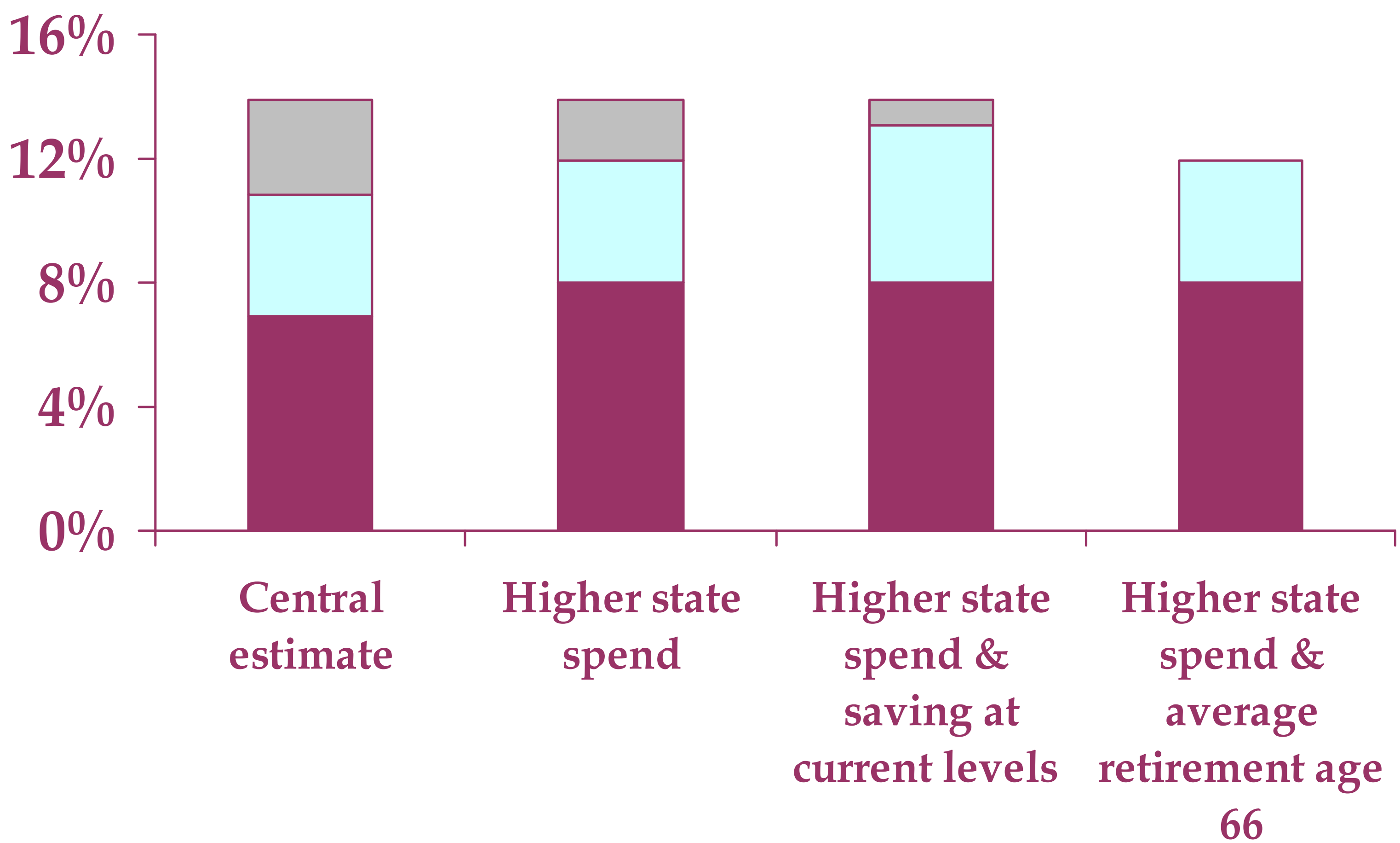

To fill the ‘gap’ ….

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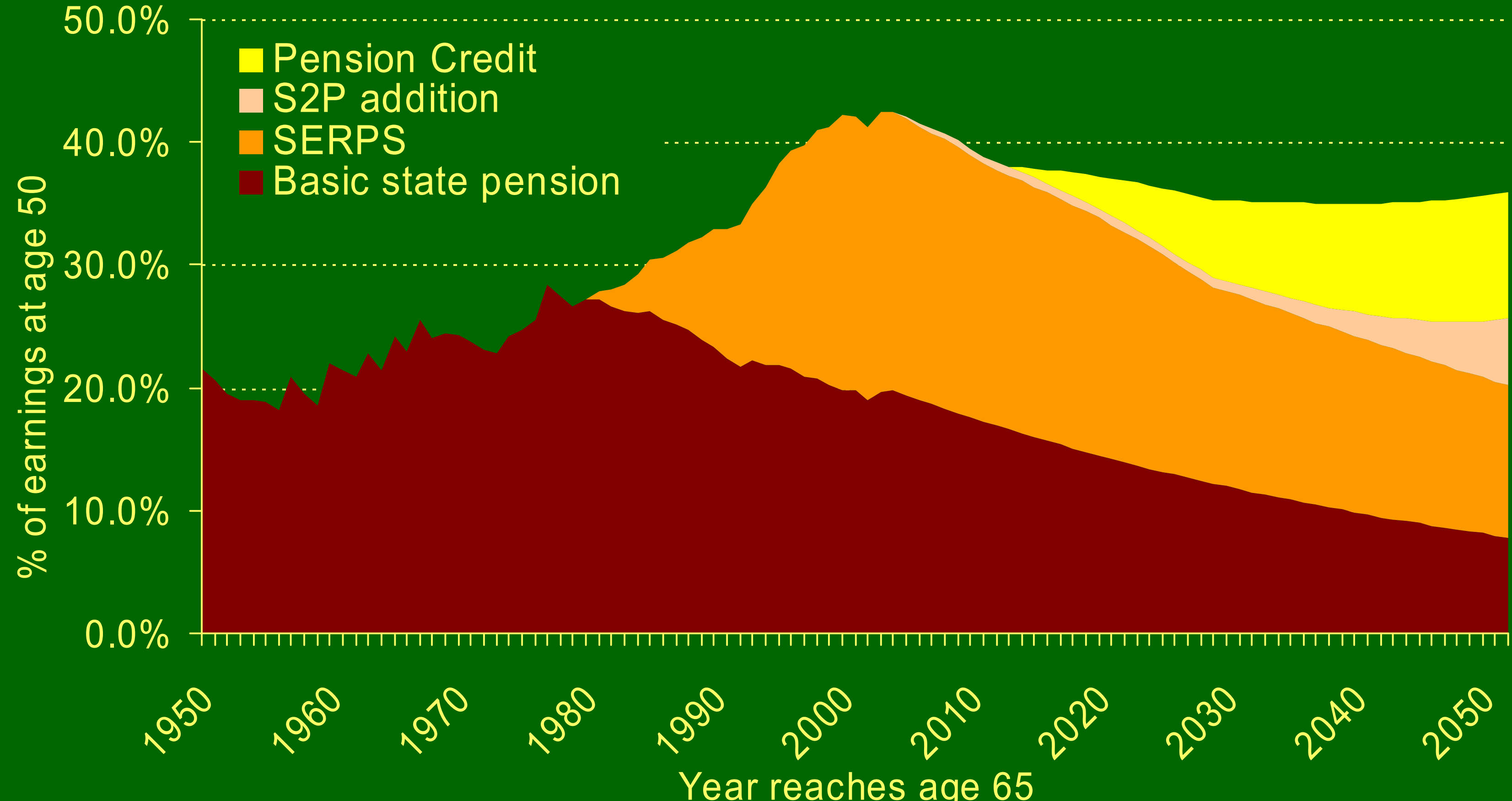
- **Without better state pensions**: need to save more and work longer
- **With better state pensions**: working longer or saving more becomes more feasible

Taxes, benefits and retirement income incentives

Carl Emmerson
Institute for Fiscal Studies

Generosity of state set to decline

State pension income at age 65, median earning male



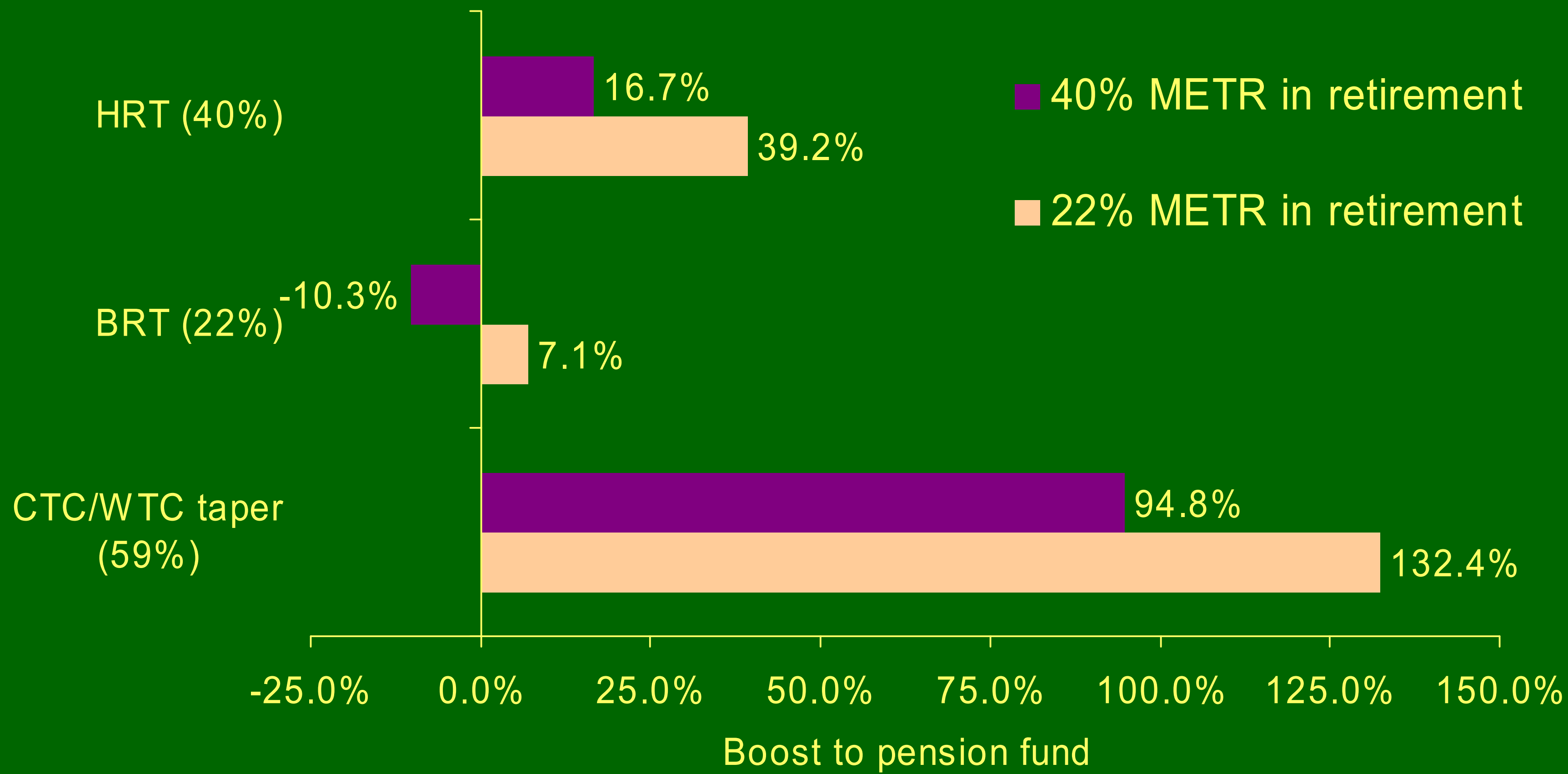
Source: Disney and Emmerson (2005)

Why save in a private pension?

- Tax-rate smoothing
- Tax-free lump sum
- Employer contributions not subject to employer or employee NICs

Incentives to save in a pension

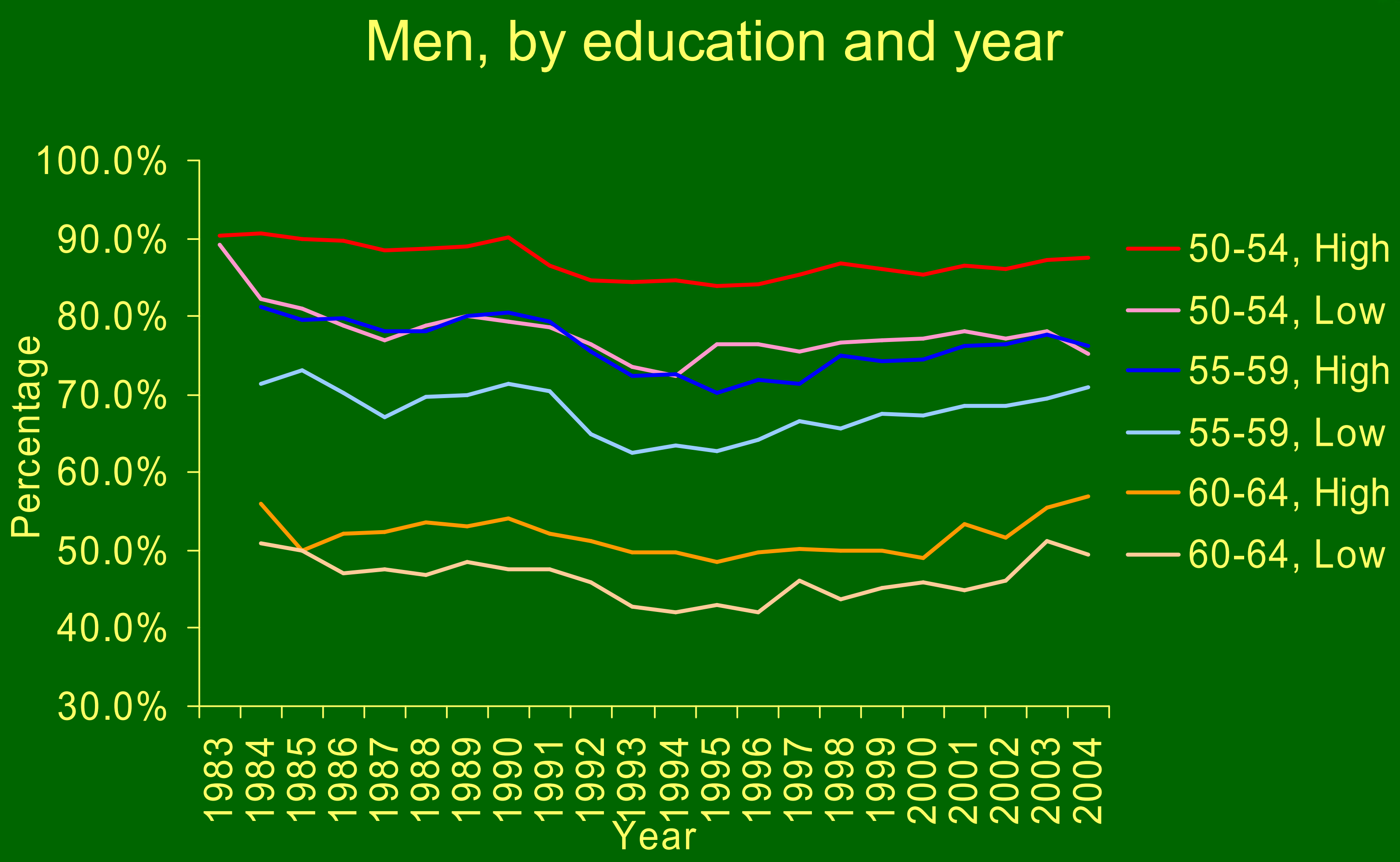
Boost to individual contributions relative to ISA treatment



Timing of pension contributions

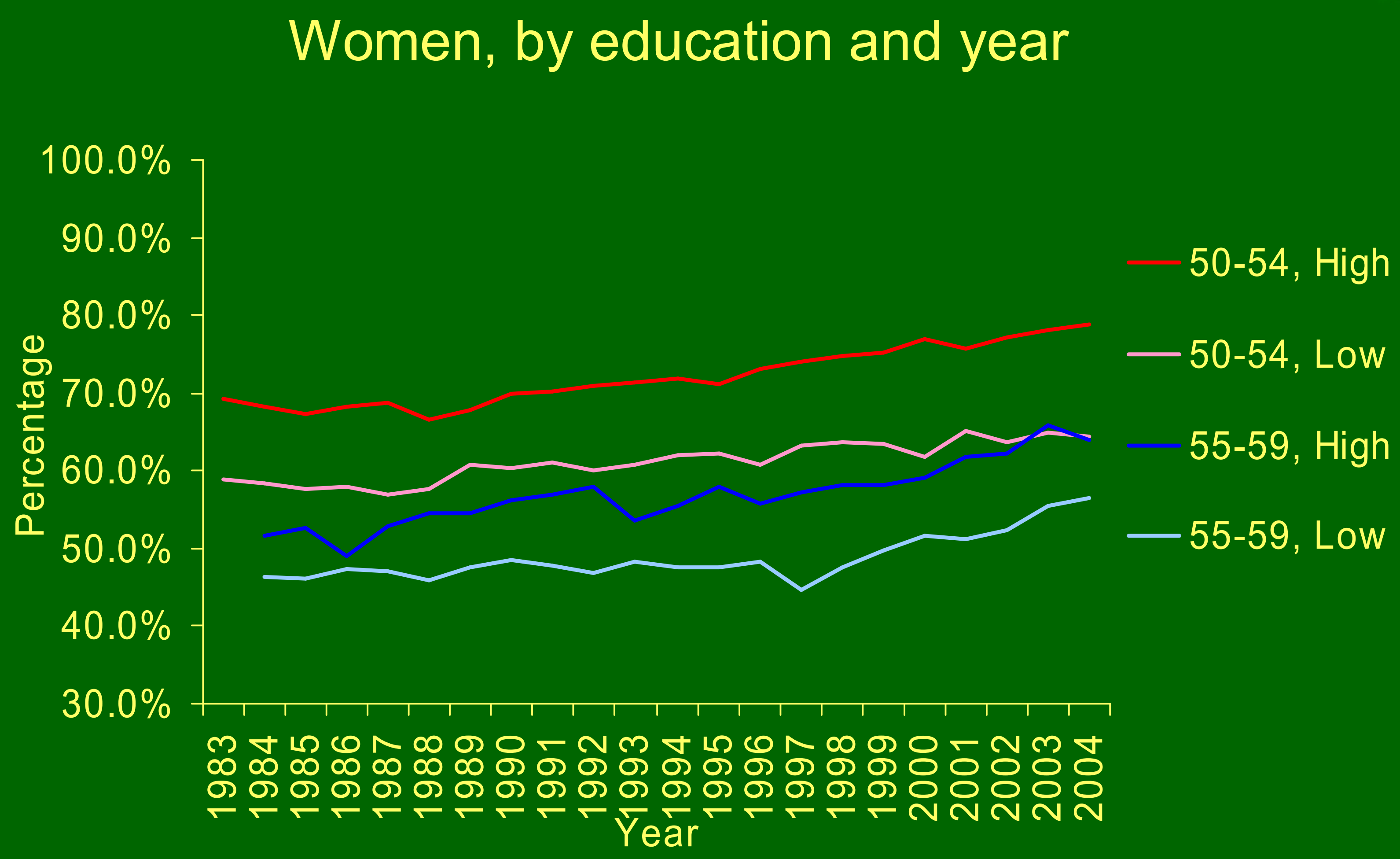
- Delaying contributions could be a sensible strategy for many individuals
- Government could just subsidise the purchase of annuities?
- Concern that individuals might not build up sufficient liquid assets?

Retiring later?



Source: Labour Force Survey

Retiring later?



Source: Labour Force Survey

Retiring later?

- better health / longer life expectancy
- reforms to DB pension schemes
- decline in generosity of state pension system
- increase in ‘pension’ ages
  - state pension age for women (60 to 65)
  - pension credit guarantee age (60 to 65)
- reform to invalidity/disability schemes

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DB schemes and retirement incentives

Source: Banks, Emmerson and Tetlow (2005)

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Questions

1. Are current subsidies for private pension saving well targeted?
2. Does it matter if retirement saving is not always through pensions?
3. In the long-run should different benefits be indexed at the same rate?
4. Are future increases in pension ages inevitable?