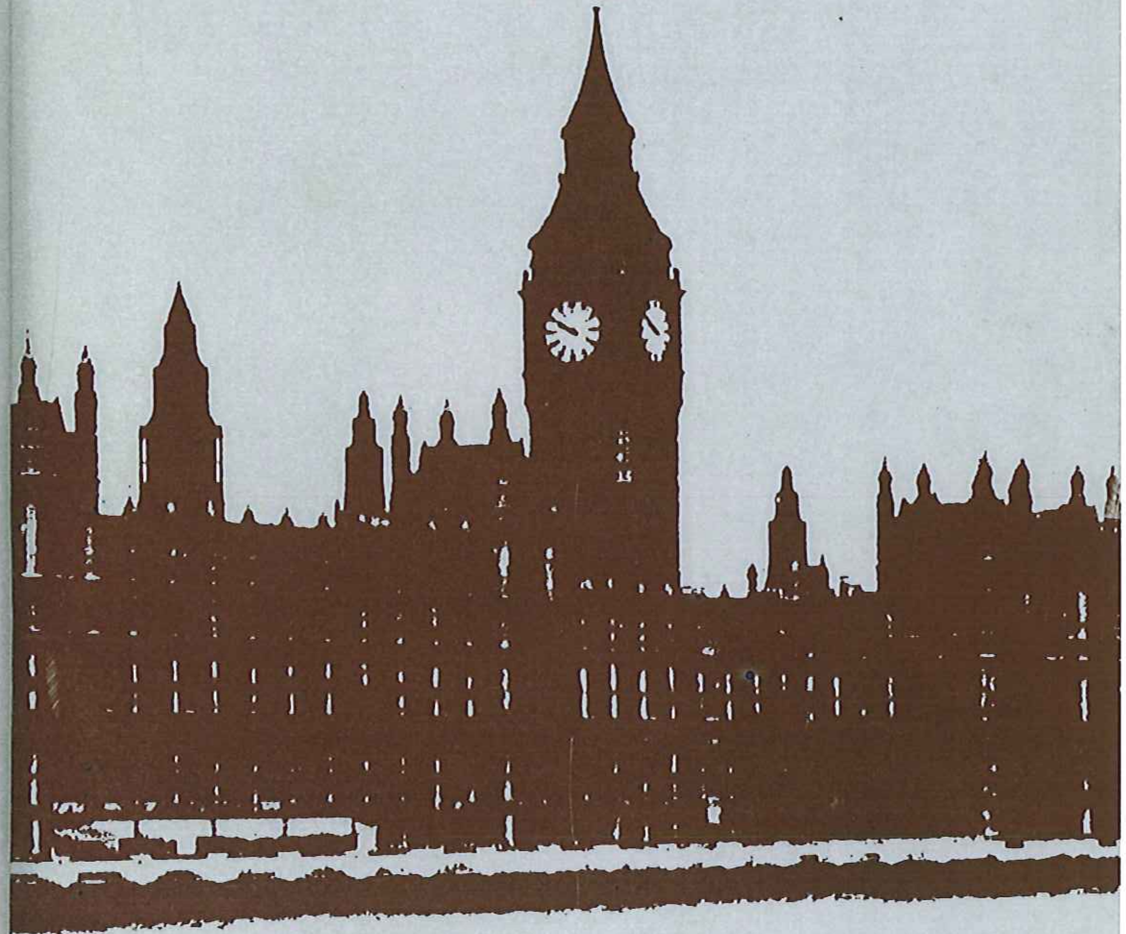
Policy Study No. 96

Pensions and Privilege

how to end the scandal, simplify taxes and widen ownership

Philip Chappell



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8 Wilfred Street, London SW1E 6PL
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The author

Philip Chappell retired from Morgan Grenfell at the end of 1985 after over 30 years service and is now Adviser to the Association of Investment Trust Companies, and a Director of other companies. This paper is written in his personal capacity and may not necessarily reflect the views of other organisations with which he is associated.

With Lord Vinson, Chairman of the Centre's Wider Ownership Group, he was co-author of *Personal and Portable Pensions – For All* in 1983 and of *Owners All – Personal Investment Pools* in 1985, both published by the Centre for Policy Studies.

The Group has consistently pressed for reforms to encourage wider ownership (the best guarantee of political freedom), arguing in particular that the pension system should be reformed in order to protect the early leaver, to provide more personal involvement and, in the fiscal field, to promote equality of tax treatment for all forms of savings.

Acknowledgements

The author gratefully acknowledges the help given by all the members of the Group in various discussions over the years.

'So these are the main principles we start with – neutrality and simplicity, a broad tax base and as low rates of tax as possible.'

Mr John Moore: May 1984: then Financial Secretary to the Treasury

'The greatest threat we face is of the Nanny State. Its agents are the Moral Minority, who believe that Nanny knows best: they will oblige us to conform to *their* idea of *our* welfare.'

Bernard Levin: The Times 20 October 1986

'The reduction in the highest rates could and should have been paid for by a much more fundamental attack on perks, privileges and anomalies'.

Samuel Brittan: Financial Times 17 March 1988

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Foreword

It happened inadvertently, it was not premeditated and the consequences were unforeseen – but giving pension funds tax exempt status has led to the greatest shift of ownership from individuals to institutions since the opposite happened at the time of the Dissolution of the Monasteries.

And the process is accelerating. Yet it runs clean contrary to a fundamental principle of Tory philosophy, namely that the diffusion of economic power, and the multiple sources of patronage which flow from it, are prerequisites of a free society.

So the process must be reversed before it is too late. Philip Chappell advocates two steps made possible by the Government's introduction of personal and portable pensions. The first is that any individual should have an annual right to transfer his fair share from an institutionally administered pension fund into a Personal Option Pension. Such a unitisation of funds would, at no extra cost, begin to turn what is now nobody's money back into somebody's money. The institutions would become administrators, not owners.

A good step. But it would not go far enough. At present huge transfers of assets from the working to the non-working are hidden under a panoply of fiscal privilege and cross subsidies that few citizens are aware of. So the paper calls for a new transparency in tax and social security arrangements. It demonstrates that, by removing tax exemption from all future pensions saving, the general levels of tax could drop dramatically: and that most other tax privileges would then become irrelevant. With the consolidation of many minor taxes, and the abolition of all higher rate income tax, the tax law becomes hugely simplified.

From this base, and from an enhanced national old age pension, the individual would be encouraged to save as he pleased. Such a move would have a double benefit. It would lower the desperate social barrier of the poverty trap. And it would relate additional retirement provision to the initiative of personal saving rather than the chance of working history. As an educated citizenry struggles from the bonds of state paternalism, Personal Option Pensions and tax reform would enable everybody to keep a higher proportion of their earnings and develop an understanding of the capital which already (but invisibly) underpins their future.

Because pensions are so complex a subject, their immense influence on our economic and social structure does not secure them the attention they deserve. Philip Chappell, in this pamphlet, 'thinks the unthinkable'. Not for the first time the Centre for Policy Studies, through its Studies and Challenges, is one step ahead of contemporary wisdom.

NIGEL VINSON
Chairman, Wider Ownership Group

The main themes

The number of shareholders in Britain has grown dramatically in the last five years, but the proportion of equities held by individuals continues to decline. British pension funds are continuing to grow, far faster than net personal wealth, and are 'crowding out' the private investor. Pension funds are also far more dominant in Britain than in our major overseas competitors; we need a better balance between structured retirement provision and flexible, personal, thrift.

The solution is to recognise pension funds for what they really are – the property of the workforce; the first key proposal is that each member, including deferred members and pensioners, should then be given an annual opportunity to take their assessed share in their fund. It would be managed by existing institutions, but as a unitised personal and portable asset.

This leads to the second key proposal, a reconsideration of the tax relief for retirement provision, the extent of which has never been widely understood; it is the single privilege whose removal opens the way to wholesale simplification of the tax system. What started as a modest allowance to benefit the long-serving worker (probably not a taxpayer at the time) has become a major tax benefit to all employees, worth as much as 40% of salary for a senior executive.

All resources in existing funds would remain on the present gross fund basis and no-one would forego any entitlements already earned. The full changeover to the new system would take up to 40 years, giving full time for education and understanding of its effects.

All future pension contributions by an employer would be treated as a benefit-in-kind and taxable in the same way as wages; employee contributions would no longer be tax allowable.

The total flow of savings would remain largely unchanged but in due course a three tier level of retirement provision would apply:- basic State, employers' top-up, and personal arrangements.

The tax change broadens the taxable base by £25 billion and allows elimination of the higher rate of income tax. Income tax could be levied at a single flat-rate of 15%, plus 7.5% on all incomes in place of employees' National Insurance Contributions. The next major step would be to eliminate all personal allowances and reliefs, and reduce the flat-rate tax to a 10% income tax, plus a 7.5% social welfare tax. A major reform of taxes on capital is also required to ensure simplicity.

Wider ownership becomes a reality, with over £200 billion allocatable to 16 million individuals. The tax system becomes comprehensible. Those who defend the present system must be challenged with the choice:- do you prefer a panoply of privilege – or the simplicity of neutrality?

Introduction

At first sight, this paper is about pension funds and tax reform and it falls naturally into those two parts: but the underlying theme is determined by a philosophical commitment to wider ownership. Ownership is a fundamental human instinct: one which should be encouraged in any free society whose members believe in their ability to be responsible citizens, capable of making their own decisions. But ownership must be personal; only thus can it give independence to the individual and secure the dispersal of economic power and patronage. *Institutionalised* capitalism is an enemy of the open society.

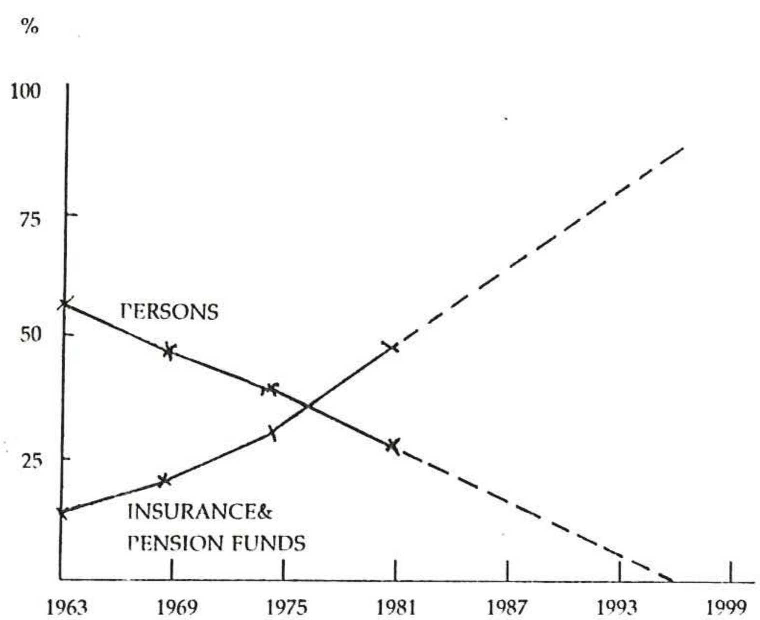
Yet, apart from the important field of home ownership, post-war Britain has seen a growth in the institutionalisation of wealth: despite the commitment of the present Government to wider share ownership and the huge increase in the *number* of shareholders, the *proportion* of financial assets owned by pension funds and life assurance companies continues to grow (see Chart 1 overleaf). This trend has received too little attention. Most of us postpone thinking about retirement, and saving for retirement; our eyes glaze over; and the complexity of the present system inhibits debate. Policies about pensions have been left to the experts, while popular comment tends rather to focus on the growing proportion of the population above normal retirement age.

The results are plain to see. Most of the capital of British companies is owned by those who at best are no more than trustees. The beneficiaries, the British workforce, are uninvolved and have little understanding of the importance of our industrial success. The nature of capitalism, thrift and wealth are alien concepts to many. Phrases such as 'second-hand ownership', 'nobody's money', 'short-termism', express this criticism of the present system. The institutionalisation of pensions cloaks the reality of ownership. Nearly five years ago (17 September 1983) the *Economist* commented:- 'Secure in their tax breaks, the investment philosophy of the new breed of City Barons, the investment managers of the big institutions, mirrors the cautious attitude of many in British industry': the assets of the funds were dubbed 'civil servant assets'.

Nothing has changed in the last five years, except that the

Chart I

Ownership of UK Listed Equities



barons have extended their feoff; they have become today's equivalent of the landed gentry who resisted the repeal of the Corn Laws in the last century.

The cure does not lie in superficial suggestions to strengthen the role of the institutions as nominal owners; the preferable solution is a radical reform, returning direct ownership of pension funds to individuals. For pension funds belong to the workforce; they are not a City toy, or a tax haven for the employer. The first part of this paper addresses this issue.

The second part calls for radical reform of the tax system as it affects savings. Many people purport to favour a level playing field for all forms of saving; but the major tax privileges still given to retirement provision (and other perks beloved by entrenched interests) distort the structure. Individuals have been shrewd enough to realise these privileges and have voted with their pockets accordingly.

Marginal tax rates on income are probably unintended, and certainly not well understood; many commentators have written about employees' National Insurance Contributions, which are non-deductible and can devastate marginal incomes at the lower levels, one form of the poverty trap: for most people, earning between £105 and £305 a week NICs are now charged at nine per cent if contracted in. But fewer commentators have drawn attention to the proportion of a senior manager's remuneration which comes through employers' pension contributions and other perks on a tax free basis – a recent management consultant's report suggested that up to an additional 45% of salary was packaged in this way.

Following the 1988 Budget, a senior executive may actually pay a lower marginal rate of tax on his earned income than his junior employee. Here is an example:-

> A man on average earnings, not contracted-out of the State pension scheme, will pay income tax at 25% and national insurance of 9%, a total of 34%. The marginal tax rate paid by his senior manager in a non contributory occupational pension scheme (even assuming only 20 per cent employers' contribution rate) will be 40 per cent of 120 i.e. 33.33 per cent, calculated as 40 per cent on his actual income and nil on the associated tax free perk of pension contribution.

Marginal tax rates on unearned income are perhaps even more absurd, jumping from nil to 25% with a higher rate of 40% on taxable income from £19,300.

These figures may surprise those unconcerned with fiscal reform. A prime aim of the taxation system advocated in this paper is that it should be simple and equitable, and unbiased as between earned and unearned income.

Many poverty action groups may care to note that taxes on earned income are far less progressive than often assumed. A simple, proportionate,income tax would achieve the same result, wasting nothing on special incentives and reliefs, and avoiding the problems of the so-called poverty trap.

With absurdity comes complexity and an army of advisers concerned to exploit fiscal privileges and minimise the impact of taxes. But the basic truth is that one man's tax privilege is another man's tax burden.

Complex tax systems are the up-market equivalent of providing employment by digging holes in the road and filling them up again.

Undoing the privileges given to retirement provision is the most important key to tax simplification and equity. Public understanding of the privileges given to retirement provision is slight. On one argument they are worth nearly twice mortgage interest reliefs. By removing these privileges for the future (but leaving existing arrangements intact) the way would lie open for a flat- rate income tax. In the process, all other perks and reliefs would be devalued and could be left to wither. Choice between immediate consumption and saving for retirement would no longer be influenced by fiscal privilege. The savings market would be freer. The possession of financial assets would follow the lead set by home ownership – a flexible and personal pattern adapted to the changing needs of the saver.

This paper was designed well before the global stock market re-alignments of October 1987. But those who sought to argue that stock market changes of this nature destroyed the arguments for personal ownership of retirement provision forgot to observe two trends.

First, the froth of the run-up, and the crash itself, might never have happened if investment policy had been in the hands of millions of individuals rather than on the screens of computers, or in the heads of global fund managers with their eyes fixed on the short-term. Second, even taking into account recent market falls, the assets of pension funds have shown a compound annual return of about 18% for the past five years, as compared with average annual earnings increases for the period of under 8%. For most people, a Personal Pension would still have provided a far better financial return than an occupational pension based on final salary. It is a portable "pot of gold", transferable from job to job, and a claim on future wealth creation.

These two themes, unitising pensions and ending their fiscal privilege, are of course independent of each other. So the two sections of this paper stand on their own feet. They are linked together as a package to emphasise the development of personal responsibility implicit in both proposals. Wider ownership and major tax reform can win votes; they are also fundamental beliefs of anyone opposed to centralism and bureaucracy.

The 1988 Budget was a great achievement and reinforces the Government's intention to return to the individual as many as possible of the State's powers. But, as many have noticed, it has done little to remove the fiscal distortions in the savings market. Personal Equity Plans and a diminished BES do little to offset the expensive privileges caused by the favoured status of retirement provision.

Pension funds in Britain have developed 'immoderate greatness', the prime cause (according to Gibbon) of the Decline of the Roman Empire. Further Budgets in this Parliament must tackle the need to disperse this immoderate greatness of their's, by returning economic and financial power to individuals. Only then can the Tory vision of property owning democracy come about.

1

A new structure for pension funds

The shambles of retirement provisions

Arrangements for retirement in Britain do not meet reasonable aspirations – and should not require fiscal privilege to support them. Everyone is now prepared to accept that the system built up in the 1970s was inequitable, misunderstood, and inadequate to meet the needs of a more mobile workforce.

The publication in 1983 of *Personal and Portable Pensions – For All*[1] coincided with the determination of this Government radically to revise pension provision. Yet five years later the proposals in that document have been so eroded, both by those seeking to preserve entrenched positions and by the problems of taxation in a minefield of privilege, that a new initiative is urgent. 'The Muddle Over Pensions', 'Myopia About Retirement' were Financial Times headlines, not in 1980 before the present reforms, but in 1986 when the full structure of the new Social Security Act was known.

The proposals in this paper leave intact all the benefits which have accrued to individuals, use the existing structure as far as possible, but create opportunities for reform which can endure. They bring together the recognition of the individual's rights, the acceptance of a responsible employer's duties, and the growing interest (world-wide) in tax reform. Pension reform has to provide a framework which will last the lifetime of today's youngest employee, a planning period of not less than sixty years, looking ahead to social and economic conditions at present unforeseen. It would be remarkable indeed if a structure which still retains much of the feudal paternalism of the 1930s was well adapted to the different conditions of the middle of the 21st century. Flexibility and personal responsibility are the key requirements of an enduring system.

Most people would probably agree on the main desirable features of retirement provision; they are set out in column 1 of the matrix below. Column 2 analyses how such objectives might be met in an ideal system and column 3 how far our present system falls short of those objectives. Heading by heading, it is a damning indictment of our present short-sightedness.

Retirement provision

Tomorrow's ideal, to-day's reality

		Analysis	*The Present Shambles*
1	Limit the role of the State	Since the State itself has no money, all it can do is channel resources from one group of citizens to another. In promising retirement benefits many years away, all the State is doing is committing future taxpayers to a transfer of resources: a so-called contributory system is a misnomer. Ideally, State support should be given only to the disadvantaged.	The present State pension, on its own, is inadequate to support the old in an acceptable living standard, so that an array of social security support systems is provided to supplement it. The State does pay pensions to those who may not need it, and even pays an additional pension (SERPS) to the fortunate, those who have been in employment, leaving the unfortunate to exploit the system as best they can.
2	Recognise the responsibility of employers	Private sector provision originated in the best sense of paternalism, i.e., from employers determined that at least their long-serving employees would enjoy a basic standard of living in retirement, better than that which would be available under the State system. They were also concerned to protect the families of employees who died in service. It is less clear how employers came to accept an expected obligation to maintain a standard of living in retirement which matched the income of the workforce while in employment.	The design of final salary schemes inevitably penalises early leavers – no amount of legislation on revaluing deferred benefits can avoid this basic flaw. Employers began to see pension provision as a form of golden handcuffs on their most valued employees. Problems of economic forecasting up to sixty years ahead also makes it inevitable that the actuarial requirement for funding is full of uncertainty, leading to under-funding or, more probably based on caution, over-provision; over-funding in turn leads to under-statement of corporate profitability, with all the ongoing implications for investment decisions, dividend policy, and public perception.

3	Encourage personal savings	The need to develop a wide power base of individuals, enjoying the independence that ownership of financial assets alone can provide, ought to be a prime requirement. Individuals may decide to choose a collective investment vehicle, to spread their risk, enjoy skilled management, and reduce costs; but it should never be imposed on them.	Despite the campaign to encourage personal shareholders, the increasing dominance of pension funds continues and, on all present assumptions will continue to grow. Pension funds in Britain are far more dominant than in our major international competitors (appendix E).
4	Ensure job mobility	The concept of 'career jobs' is increasingly replaced by those who believe in varied job patterns, including the ability to move in and out of the workforce, or to become a part-time employee or enjoy multiple employment. This is especially important for women wishing to leave and re-enter the workforce. Public policy should encourage job mobility.	Employers have, naturally, a vested interest in retaining their workforce, if only on the grounds of retraining costs: but they should achieve this through good employment practice, not fiscal subsidy. Present occupational schemes are well-suited to, and well-supported in public argument, by 55 year olds with 35 years service and five years to retirement: only personal provision can meet the needs of mobile employees.
5	Clarify employees' understanding and involvement	If savings are to be made on behalf of an individual, there are two fundamental requirements: (a) he must be kept well-informed about the nature and growth of his assets, the investment policy, the quality of any guaranteed benefit (b) he must fully understand his rights in various circumstances of death, retirement and leaving early.	Some progress has at long last been made in requiring occupational pension funds to make annual disclosure to their members of their investment policy: but no information need be given on portfolio performance or on the details of actuarial solvency. More seriously, the ultimate ownership of the fund, and any surplus it is found to contain, remains uncertain: some have argued that it belongs to the employer, as the major contributor and ultimate guarantor, others to

		It is, of course, far preferable that most savings should be the direct property of the individual, so that it is accessible for his varied needs at different stages of a normal lifespan.	employees, on the basis that all contributions are deferred pay. Individuals can hardly be expected to take an interest in the successful performance of the portfolio, i.e. largely the success of the country if they cannot understand how that stake is calculated.
6	Provide fiscal neutrality for all forms of saving	An ideal tax system offers no privileges, allowances or concessions, in the full understanding that one man's tax privilege is another man's tax burden, and in the recognition that the State has no role to play in distorting personal decisions by fiscal privilege. In the real world pressure groups do secure concessions for what is seen to be socially desirable: but at the very least such concessions should be transparent, limited in amount, understood by the beneficiary and properly subject to public debate.	The fiscal privileges surrounding retirement provision are the biggest single distortion in the savings market. We suffer from the absurdity that no tax concession is available for the so-called contributory system of basic State provision (which all applaud): but occupational schemes enjoy privileges which have been little understood and are far more generous than is realised: privileges to the self-employed are also available on a less generous basis. The articulate minority are the major beneficiaries, with non taxable contributions being made to occupational schemes which may represent 40% or more of salary. Even if some modest concession might have been appropriate to encourage personal saving and ensure that the old are not a 'burden on the State', it should never have been extended to cover contributions which need only an actuarial certificate to justify their amount. £500 p.a. for all might be justified: an annual £40,000 tax free perk for a senior manager on £100,000 p.a. was surely never intended. Even worse, a senior manager receiving

			a salary increase in the last year of his service in excess of the actuarial assumptions will need a a pension contribution of at least ten times his salary increase to fund the enlarged liability.
7	Avoid cross-subsidisation	There is an inherent objection to all forms of cross-subsidisation, at least unless all the parties fully understand and agree what is happening. In insurance, for example, a group of individuals may club together on a voluntary basis to provide mutual support against the human risk of mortality or loss of property. It is far less acceptable for an employer to impose cross-subsidies on his employees, without their even realising it is happening: in many cases not even the employer appreciates the full extent of pension costs and how they vary with age, thus reducing opportunities for the young to enter the workforce.	Cross-subsidisation is inherent in any final salary scheme and is the fundamental criticism of such a basis. But in this case it is not the strong who help the weak but exactly the opposite: the gainers from final salary schemes are the high-fliers, the married, the long-servers and the female: the losers are the majority of the workforce (there are more plodders than high-fliers), the single, the mobile and the male. It is surprising that organised labour has not yet woken up to the present inequities; in Christopher Fildes' more colourful phrase:- 'trade union leaders should have a proper dislike of watering the workers' beer,' an inevitable outcome of occupational pension schemes based on final salary.

A new approach to pension provision

On almost every count the present system fails to meet the desirable objectives – and as funds grow yet more dominant, it becomes ever harder to re-construct a system which will meet the future's needs. We have to recognise the variety of expectations that have been established, on the basis of which many personal financial transactions (such as pension mortgages, however inappropriate) depend. It is clearly essential that all existing commitments in respect of employment to date, whether from the State or private sector funds, must be honoured. Criticism can be expected from those who will calculating their personal position under the new proposals. So it is vital to emphasise that *no-one foregoes any entitlements already earned by past service.*

The State's role

The role of State pension provision is outside the main scope of this paper: on fiscal policy, however, it must be desirable that present National Insurance contributions (nearly half of which are presently dedicated to the payment of State retirement pensions) should be integrated with personal income tax, perhaps under a new title of 'Social Tax'. All earnings, and all other forms of income, would become subject to this tax: the figment of the contribution basis is abandoned, its range is extended to make it fairer, and a major simplification of the tax system, currently collected on two different systems by two different Departments, is achieved.

A fairer formula for the basic State Pension is needed, while recognising that its level must always be a matter for political agreement at the time among the voters of the day; it is they who have to be persuaded to accept the transfer of resources from the economically active workforce to the retired. It should be available to all citizens, regardless of their employment history, and related to average earnings, as a fairer reflection of the relative prosperity of the day. The amount of State pension must remain at a level where there is real incentive for the individual, on his own account or through his employer, to provide additional resource for his retirement: it follows that some level of supplemental support, and machinery to implement it, will always be required to meet the needs of the spendthrift, the disadvantaged and the unlucky.

The debates of 1985 about SERPS would be ended at a stroke by ending SERPS. The Government erred in that debate by allowing the argument to centre round future costs. They failed to take the high ground of political argument by stating clearly that, while it may be the task of the State to help the disadvantaged, it is certainly not its job to add to the advantages of those who have been employed. SERPS is part of the tradition of consensus of the mid 1970s and should be scrapped along with all the other intellectual impedimenta of that decade. It may be expensive, even when diminished through Personal Pensions, but the more effective attack is that it is inequitable, unjustified, and hopelessly complicated.

The proposed solution – Personal Option Pensions

The main structural reform calls for one simple change to pensions provided in the private sector. First it should be agreed that all past contributions to a fund are deferred pay and, therefore, that all monies in it belong exclusively, as of right, to the members. Next units in the fund should be offered to members – an easy transition.

Once-for-all unitisation of pension funds may well have been considered before. But the present proposal envisages that unitisation would be an option exercisable annually. Personal Option Pensions, with their convenient acronym of POPs, signify the opportunity for individual choice. In detail, the proposal would operate as follows:

(a) As a condition of continuing approval by the Superannuation Funds Office, each separate fund would be required to *produce a discontinuance valuation* on at least an annual basis.

(A discontinuance valuation, in outline, calculates the liabilities that would arise if the fund were to be closed at the valuation date, and measures such liabilities against the market value of the assets at that date. With modern technology, and proper pre-planning, a discontinuance valuation can be prepared both cheaply and quickly. It is a much simpler calculation than a projected liabilities valuation, since it uses market value for the assets and does not require any long-term assumptions to be made about income growth, patterns of future earnings, early leavers, or prices: it is these assumptions which cause all the difficulties in long-term pension funding. The details of such a discontinuance valuation should in any event be published, as a matter of good accounting practice, as part of a company's annual balance sheet; such a valuation, and any surplus or deficit revealed thereby, is of considerable interest to anyone assessing the value of a company).

(b) Each member of the fund,including all deferred members and pensioners, would be given *an annual benefit statement* based on this valuation: and this statement would show the individual's percentage share of the fund and its capital value at valuation date. The basis on which the individual shares were calculated would be within guidelines established by the Government Actuary and agreed by the Trustees: mortality assumptions are the most significant risk. The essential point is that since the whole fund belongs to the members, the aggregate percentage shares must add up to 100, and the aggregate capital values so calculated must add up to the total market value of the fund.

(c) *The key element of the proposal is that each member, including deferred members and pensioners, would have an absolute annual right to transfer a specified percentage (not less than 95%) of his share as assessed into a segregated personal fund, in exchange for abandoning his accrued rights.* An employer could require anyone leaving the company, other than on normal retirement arrangements, to accept his assessed share and thereby lose all claim on the fund. The option could be exercised by the employee on each annual valuation, so that he would earn an annual increment to his segregated fund; but, if only for simplicity of administration, the option must be exercised in respect of all past service and the employee should not be able to maintain a partial claim on the fund. The specified percentage would be determined by the trustees, provided it is not less than 95%: the small margin leaves scope for valuation uncertainties, and is designed to allow the Trustees of the ongoing fund to have a modicum of uncommitted resource to aid special cases.

(d) Given present tax treatment of retirement provision, the segregated personal fund would be a gross fund, free of income and gains tax: and a pension could be drawn out of it only on normal retirement, or earlier retirement on agreed ill health grounds. But the actual retirement date selected could be flexible, on the same basis as that now available to the self-employed.

The personal funds would, therefore, be like those to be established under the new Personal Pension rules: in that sense this proposal does no more than extend to back service what has now been accepted for future service. The main difference is that, since the employer cannot know which option the employee will select each year, he must continue to contribute on behalf of all members accepted into the scheme. One of the inequities of the new Personal Pension regime is that the employer is not legally required to make any contribution at all to employees who opt out of the occupational scheme in favour of making their own personal provision. But the employer is saved the appropriate contribution to the occupational scheme; and this saving should be reflected in the employee's total remuneration. (A few private sector companies have indicated that they will make a top up payment to employees who opt for personal pensions: it is doubly unfortunate that this Government, so enthusiastic in principle to support personal pensions, has failed to set such an example of good practice in respect of its own employees.)

(e) Though there would be no real justification, the Inland Revenue would probably insist that such segregated funds be administered by an *authorised depository*, existing funds doubtless being authorised so to act. But the individual must be free to choose his depository, and transfer from one to another, provided he bears the costs of doing so. Initially, at least, there would be some constraints on investment flexibility and a minimum quantum for each individual should be held in a limited range of authorised investments (bank deposits, gilts or broadly-based investment vehicles) to ensure, for

example, at least a 50% increase over the basic State pension at retirement: but those with substantial segregated funds should enjoy complete freedom of investment policy. While there would be no compulsion, those approaching retirement might choose to place a larger proportion of their portfolio in low-risk gilts or index-linked stocks, to minimise uncertainty at retirement date.

Specifically, there would be no restriction on using funds above the prescribed minimum for investment by the employee in shares of the employer's company, thus opening up huge new opportunities for widening ownership at the place of work. Problems of 'too many eggs in a single basket' cannot apply once the prescribed minimum has been met. It is patronising, and a denial of personal freedom, to say that individuals cannot understand the risks involved and should be forced into the merry-go-round of diversifying investments (an argument sometimes advanced by those whose business derives from recommending such diversification). It ignores the mounting evidence of the success of companies which enjoy a high degree of employee financial participation; there is, therefore, a public interest in encouraging employee ownership. The same principle would apply to unquoted and riskier investments: if an individual chooses to sink part of his retirement provision into his nephew's newly established software business, he should surely be encouraged to do so, not prevented by so-called superior wisdom. Let institutionalised investment be for those who want it; let those who prefer their own judgement be rid of the yoke.

(f) An employer could insist that an employee provided death-in-service, and ill-heath, cover for himself or family. Or he might choose to unbundle such provision from the main pension fund, opening the way for more flexible arrangements. It would be also desirable that those faced with redundancy or special hardship, before normal retirement, should have some access to their personal fund's capital value.

(g) On retirement, no one would have to take the whole segregated fund either as an annuity or a capital commutation: an individual could choose to leave his segregated fund as a gross fund, paying income tax only on amounts withdrawn. Provision for spouses would be obligatory and a limit on annual withdrawal would be necessary to ensure that a prescribed minimum level of funds always remained: but any assets remaining at the death of an individual (as of his spouse and dependents) would accrue to his estate. There would be no objection to anyone, at any stage, placing all or part of his funds with an insurance company to spread the mortality risk: insurance companies might offer special policies that recognised the needs of long-term survivors, reversing the present pattern of term policies paying out only on death. Tontine Funds would come back into fashion, providing special protection for the longest survivors.

(h) The proposal would be extended to cover those in *unfunded schemes*, where a definite commitment to a pension accrues for each year in service: this applies mainly to state employees. If their pension right is inflation-proofed their annual benefit statement would be in the form of the right to take index-linked gilts. This has the advantage of formally recognising the cost of the notional liability which has been created, and at the same time increasing the supply of such stocks; they are the most useful measure of the market assessment of the cost of providing inflation-linked pensions, as well as providing governments with a very strong incentive to minimise inflation.

The advantages of POPs

(a) Everyone can develop an understanding about the behaviour of assets held for retirement provision. Everyone will have a direct stake in our society, want it to succeed, and can benefit visibly from the success of his investments. *Employee ownership of the wealth of Britain becomes a reality*, with all the advantages of employees' financial participation in their companies.

(b) All the arguments on early leaver entitlements, premature retirement, inflation protection, and portability become irrelevant: and job mobility is enhanced. Instead of Personal Pensions being restricted to future service, POPs open up over £200 billion to popular capitalism – an average of at least £12,500 per member (though obviously varying widely to reflect age, past service, salary pattern and family circumstances).

(c) POPs eliminate criticism of the role of institutional investors as indirect owners of UK equities; they are seen to be only managers and trustees for their beneficiaries, to whose investment decisions they must respond. (If beneficiaries support merger mania and take short-term gains, that is their business – no blame to the 'City'). Broader investment questions, eg, on ethical arguments or overseas diversification, are left to each of us to decide. If everyone is free to take his segregated funds where he will, then that is his means of criticising the investment policies of managers. Given reasonable investment flexibility for segregated funds, opportunities would emerge for backing small new firms and creating new jobs. No one denies the great support to developing companies above a certain size, given by institutional investors: but it is recognised that a gap still exists at the smallest level, where the need is for local knowledge and costs cannot be carried by a centrally-based investor.

(d) Most money would, of course, remain with the same institutions, either as part of a continuing main fund or as managers of personal segregated funds; costs and administrative saving alone ensure the latter. But at least the monopoly principle would have been broken. The change in property rights would be fundamental. The average employee would have his personal funds managed by his present institutional manager but would enjoy complete freedom to take them elsewhere if he chooses: his financial understanding would therefore be far greater than that of the employee who at present has an ill-defined stake in a remote pension fund. Those who argue that personalising pensions will only re-introduce institutional investment dominance in another guise have not understood this crucial difference; they have only to ask the self-employed, to whom existing money-purchase policies have offered just this realisation. A whole new market for managers of broadly-based investment funds would be opened, with all the advantages of pooled costs. Opportunities for local financial advice from intermediaries, based on the individual's family and other circumstances, become a reality.

(e) The cross-subsidisation inherent in all final salary schemes would be more clearly seen, and better understood. In the past it has hardly been in the interests of the articulate minority, who gain from the system, to explain the detail to the wider majority, who lose. The simple explanation lies in the "aggregate funding rate" (the phrase used for the level of contribution to be made to an occupational pension scheme on the recommendation of its actuary). This is paid, as an equal percentage rate, on behalf of all the active members. It must be obvious that, age for age, a married member of the scheme, with entitlements to spouses' or children's benefits, is likely to cost the scheme more than an unmarried member; it should be equally clear that anyone who enjoys above-average increases in their salaries, most especially in the years approaching retirement, is more expensive to the Scheme than a member whose salary progression is limited to the average or is below it. Women live longer in retirement and may retire earlier; they therefore represent a greater drain on the fund's resources than men. The young subsidise the old and early leavers subsidise the long-term career stayers. Everyone may understand that, as personal circumstances change, the claims on the fund continuously vary: what is less often said is that the same principle applies as to tax privileges – *one employee's gain must be matched by another employee's loss*. There may well be a general social argument for the strong, or the lucky, giving some support to the weak or the disadvantaged; the fundamental criticism of final salary schemes is that it is the strong (who are in the minority) who are the gainers, at the expense of the weak.

Those who opted annually for withdrawal would understand much better the true cost of retirement provision depending on age, salary and personal

background: (interestingly, it might encourage the young to remain in occupational schemes until marriage, to get credit for back service, albeit unmarried for most of that period). Employers who decided to continue with final salary schemes would continue to make annual contributions, with or without members' contributions, expressed at the aggregate funding rate, in respect of all employees in the scheme.

(f) The administrative problems of pension managers would be reduced: all the snippets of future pensions in respect of past service of mobile employees would be rolled up into one single fund, if the employer exercised his right to require an early leaver to take this segregated fund option. It clarifies the principle that an employer's obligation to early leavers is concluded at the date of his departure.

(g) The debate about pension funds surpluses would be resolved for employers, members and the Inland Revenue. It would be clear that moneys passed over to pension fund trustees were the sole property of the members, with no right of recovery by the employer in any circumstances (the best funds already accept this principle).

(h) All the problems about Inland Revenue limits on the permissible level of pension are eliminated: those who choose Personal Option Pensions effectively possess money purchase schemes and the only limit is on the amount of contributions, not on the size of the fund that can be built up to provide benefits. Far greater flexibility on actual retirement date is available to an individual with a segregated fund, to take account of both personal circumstances and employers' wishes.

(i) Complete protection is available to the employees, and the pensioners, where control of a company changes and the appointment of Trustees (and therewith control of the pension fund), falls into new hands. The predator cannot claw-back if all members have an inalienable right to extract their assessed share: pensioners are no longer at the mercy of their former employer's pension fund.

The criticisms of POPs

All simple proposals have their critics and Personal Option Pensions will find objectors among the paternalists, the technocrats, the vested interests and some employers. The first task is to persuade the critics that more and more people realise that the present position is unjust and untenable: the threat of external interference should induce new strategic thinking. Six main strands of criticism of Personal Option Pensions have been identified: but the answers are straightforward and convincing. They will be found in Appendix A.

The link between personal pensions and tax reform

What is important now is to stress the link between personal pensions and tax reform: a link which could transform attitudes towards diffusion of wealth and the enhancement of liberty. And Personal Option Pensions could be introduced forthwith. By making the annual choice an option, no one is forced into a money-purchase scheme against his will: by making the annual choice available, the criticisms of the ossified structure are eliminated and unitisation offers the prospect of wider ownership – to all the existing members. Personal responsibility for retirement provision becomes much more widely understood and could be progressively implemented over the next generation.

But such a change would still only tinker with the distortions in the savings market: so long as one segment of everybody's expenditure is biased by fiscal privilege toward one form of saving, no-one who believes in free markets can be satisfied. Those who champion wider ownership regret that the form of saving particularly favoured by fiscal privilege enforces institutional ownership and denies to the individual the right to spend his money as he chooses. How patronising that an employer distributes 90% of remuneration to be spent as the employee chooses, but insists on retaining the last 10% to be saved for old age under a sheltered tax umbrella! A free market should facilitate access to savings, rather than insist they be kept for retirement: a good tax system gives everybody the extra wherewithal with which to save, allowing different decisions according to changing needs.

Fiscal privilege is the enemy of the savings market, of the

proper transfer of assets from today's workers to the retired, of the financial understanding which should be part of every saver's decisions. Hence the need to associate unitisation of pensions with a review of such privileges.

2

Fiscal privilege for pensions – or simpler taxes?

Broadening the tax base

Any mention of the tax privileges surrounding retirement provision encounters an instant reaction from entrenched interests. For example, the pensions lobbyists resisted fairer treatment for the Early Leaver (as recently as 1978 there was no compulsion to provide early leavers with any deferred benefit whatever, other than a return of their own contributions); they resisted (and still resist) the provision of Personal Pensions, as diminishing their role as the monopoly provider; and they mounted a major campaign in 1985 to retain tax privileges for retirement saving. What is needed, both at the popular level and by the experts, is a realisation that the present system is inequitable; and must be reformed.

Tax reformers too often argue from an analysis of the existing privileges, rehearsing their costs and discussing the effect of minor modifications. This is to look at our fiscal system through the wrong end of the telescope. The better approach is to consider the tax system as a whole. Everyone is aware of, and frustrated at a personal level by, the complexities of the present system: rather fewer may be willing to recognise that we can simplify the system only by broadening the tax base. The prime requirement must be to eliminate the burden of those many taxes which distort the balance of choice between saving and spending and act as a barrier to personal ownership.

Two stark statistics illustrate the need for change:

(i) Income Tax bites too soon: the threshold at which income tax becomes payable, expressed as a percentage of average manual earnings, has fallen from 99.8% in 1950 to 37.5% in 1987: (this figure applies to a married man with two children, but Appendix C of IR Statistics[2] sets out the full data for a wide range of personal circumstances and earnings).

(ii) Taxes on earning are too high: in 1950 the actual amount of PAYE deducted was £499 million out of total pay, plus occupational pensions, of £6.470 billion, giving a "tax percentage" of 7.7%: by 1985 those figures had grown to £30.9 billion and £157.0 billion respectively, so that the tax percentage had grown to 19.7%. On a revenue-neutral basis, the only way of reducing that percentage is to widen the base on which PAYE is levied.

The consequences are clear to anyone concerned with work incentives, and most of all to those concerned with the creation of new jobs, the problems of the poverty trap, and attitudes to taking up employment. National Insurance contributions become an additional burden on lower levels of earned income, so that the marginal rate of tax, including NICs, for an individual earning as little as £100 a week can be 34%, an absurd disincentive. NICs produce their own brand of fiscal distortion and barriers to work: they introduce a higher level of tax on earned as compared with unearned income: and they are based on arbitrary cut-off points in earnings which bear no relation to the starting levels for higher rate income taxes. National Insurance's claim to be a contributory system has always been a charade: the only argument against integrating NICs with income tax is that it exposes marginal tax rates for what they really are (as anyone with a payslip in his hand can instantly see).

Higher rate income taxes

Higher rate tax systems are themselves now open to challenge. Our present tax system, based partly on a flat rate VAT levied on a substantial proportion of personal spending, and partly on progressive taxes on income where 'ability to pay' is used as a criterion, is an obvious confusion of principles. The additional revenue from higher rate income taxes is relatively small: but they produce a demand for ratcheting salaries to take account of tax, coupled with widespread perks and privileges and an army of advisers to minimise the tax impact. It should always be remembered that it was Karl Marx who first proposed progressive taxes on income for his quite specific political motives: and that their introduction to Britain (at the rate of 5%, considered penal at the time) was for the specific semi-hypothecated programmes of national defence.

We now need to state unequivocally that *all forms of progressive taxation are a direct denial of the individual's freedom* to spend his money as he himself chooses. The debate on the 1988 budget shows how few people have understood the need to change public attitudes. Higher rate taxes are an attempt to buck the market, by trying to re-adjust salaries set by the market; as such they belong to the paraphernalia of Socialist thinking. It is time to challenge that basic set of attitudes. Pride in reducing the top rate to 40% and regarding that as the maximum objective (brave though it seemed at the time), shows that the nonsense of higher rate taxes has not yet been exposed, or that the means of earning income tax-free has not been fully understood.

The political attractions

Radical tax reform can be made politically attractive if it is seen to meet three basic demands.

(a) Does it simplify the tax system to a basis which every individual can understand and calculate for himself?

(b) Does it restore choice, allowing the individual to spend what he properly regards as his money in his order of preference?

(c) Does it widen ownership by removing the distortions which favour institutionalised savings at the expense of creation of personal assets?

Reliefs for retirement provision

The scale of the problem is such that only the removal of retirement provision relief can provide the room for manoeuvre necessary to simplify the system. A summary of these reliefs, which have often been set out in great detail, is given in Appendix B. Enough here to state that the reasons for granting reliefs go back to the very origin of occupational schemes at the beginning of the century, at a time when only a small proportion of the population paid income tax and when pensions were regarded as provision for the thriftless poorer classes, rather than as today one of the major perks of employment. It was also a time of lower interest rates and no capital gains taxes, so that gross fund status was less valuable. (The cumulative effect of gross returns are not widely understood: but after 20 years the tax-exempt owner of money earning 4% is 21% better off than a tax-payer with a basic rate of 25%: but if the total rate of return rises to 12% the exempt owner is as much as 72% better off.

(Using a tax rate of 40% the advantage to an exempt fund grows to a benefit of 37% assuming a 4% return, and 139% on a 12% return.)

The arguments for providing these reliefs were perhaps laudable at the time: a specific fiscal encouragement to postpone consumption and provide a nest egg for retirement complemented the policies of paternalist employers. No-one at that time visualised the pension commitments to today's high salary earners, where non-taxable (and non-contributory) contributions to occupational schemes may represent a tax-free increment of 40% or more of salary.

Some have even sought to argue that, since pensions are fully taxed when it comes to payment, "the tax rules under which approved pension funds operate do not put them in a privileged position:"[3]. But the long history of Revenue involvement with closing the more blatant loopholes does imply that retirement provision is encouraged by fiscal privilege, a position which most would accept.

The cost of pension fund reliefs

What is less acceptable is the virtual absence of public discussion about the true costs of these reliefs. Since it is the very small minority on the highest salaries who gain the most from the present basis of final salary schemes, this may not be altogether surprising. The under-privileged and over-taxed majority of average wage earners is being robbed to pay the minority of high fliers.

As recently as 1978, Treasury witnesses to a Select Committee were unable to give the cost of "tax relief on private pension schemes or tax reliefs on lump sum payments under public and private pension schemes, since the information needed was not available". By 1983, IR Statistics put the cost of income tax relief at £1.1 billion: but later in just the same year the Revenue published their first attempt at a detailed statistical analysis[4]. Their paper offered three separate approaches, costed at between £2.450 billion and £2.9 billion, at a time of higher tax rates than at present: but no-one attached much credence to the figures at the time and there was little public debate. It was a measure of public apathy on the issues that just one year later (see Hansard 9 January 1985 p. 491) one figure (the estimated cost of tax relief for employees in respect of employers' contributions) could be virtually doubled from £1.1 billion to a "particularly tentative" £2.1 billion: even then no-one seemed to question the detailed assumptions or why the figure had changed. A mere £1 billion of tax relief (enough to take 1p off income tax at the time) was not considered news-worthy. By 1986 (see Hansard 3 June 1986, c 532) forward projections of future costs were abandoned and it was argued that it was too expensive to calculate the costs of these reliefs in future years. But promises are being made now which will represent commitments in future years and it is unacceptable to operate a system today which burdens the next generation to an unknown extent. No attempt has been made to measure the cost of gains tax exemption – yet gains tax is possibly the single most important discouragement to wider personal ownership.

It was not until 1984 that the present Chancellor began to remove the first of the fiscal anomalies affecting savings, by ending Life Assurance Premium relief. There was therefore widespread speculation that his 1985 Budget might have wished to raid the "Pot of Gold" that retirement relief represented. In the event the political lobby mounted by the National Association of Pension Funds, described as "unprecedented" at the time, a report "Taxing Pensions" by the Institute for Fiscal Studies, and a general feeling that a run-up to an election period was not the time to propose major changes in savings flows, all combined to persuade the Chancellor to withdraw any ideas for major reform in the last Parliament.

The 1987 Budget did indeed introduce some minor changes to fiscal privilege, but they affected only lump sum commutations of over £150,000 and the accrual period for a full two-thirds final salary entitlement. But it was a signal that the present system was not perfect – and widely interpreted as such. The 1988 Budget brought major changes to the level of tax, but did nothing in the cause of fiscal neutrality in the savings market.

Why change now?

For five main reasons:-

(a) It is becoming clear that the true cost of retirement provision relief may have been substantially understated. The next section outlines a different approach to such a costing exercise.

(b) Interest in major tax reform is growing. We can now aim not just to ape the new American pattern (which still retains many fiscal privileges and distortions) but to leapfrog them. A single flat-rate low-percentage income tax is now accepted to be achievable.

(c) The system does not reflect the changing patterns of work, moving from one job to another, from employment to self-employment, the growth of part-time jobs (especially for women). Why should housewives, children, or the non-employed fund the tax privileges of the employed?

(d) New entrants to the work force should not have to face the disincentive of high marginal tax rates.

(e) Retirement provision relief, in its present form, is a direct fiscal encouragement to institutionalised saving. Employers no longer believe they are getting value for money for their contributions: and the working population has no sense of identification with their savings as represented by these funds, nor with the wealth-creating commercial activity which alone gives value to such funds.

A new approach to costing pension relief

One extreme of calculation would be to assume that all existing reliefs were withdrawn with immediate effect, or even retrospectively, with a devastating impact on the solvency on existing funds and on the legitimate expectations of present and future pensions. Such a calculation would bring into the taxable base not only all future contributions, but also the existing funds and their capital gains as realised; it would add up to £10 billion of investment income and net capital gains of some £20 billion annually to the calculation of a wider taxable base shown below.

Now this is clearly unrealistic. But it is reasonable to assume (at least for demonstrating the true costs) that existing schemes are closed to new contributions: they would continue to operate on the existing gross fund basis, paying out pensions which would themselves be subject to tax, and maintaining commutation rights, however anomalous, as at present. Such an approach *honours all existing promises* and would simplify the introduction of Personal Option Pensions. Another advantage would be that the impact on individual expectations would be gradual. Forty years would pass during which everyone would grow to understand the dynamism of personal saving. But for the future the taxation of retirement provision would be quite different:-

(a) employers could operate new occupational schemes and their contributions, just like wages and salaries, would be allowable as tax deductions in the company's computation: no limit on such contributions need be imposed but no increase in cost to employers would be involved;

(b) such new funds would be subject to income tax (at the single standard rate, since higher rates would have been abolished). Since they would operate on a tax-paying basis, they would lose the benefit of gross fund roll-up; either a higher level of contributions would be needed to maintain benefit levels, or ultimate benefits would be lower. But, following the reduction in tax rates, individuals would be more willing to set aside a higher level of savings on a purely personal basis. New funds would also be subject to gains tax as if the fund was owned by all the individual members so that an annual exemption of a fixed sum per member might be acceptable;

(c) contributions by employees, or by the self-employed, would no longer be deductible. This puts the self-employed in the same position as the employee; although an employer would continue to be able to make contributions which were deductible, the employee and the self-employed would both contribute out of their net after-tax income;

(d) as the most significant change, all contributions by employers would be regarded as employees' emoluments and assessed as a benefit-in-kind on the employee, just as if they were wages or other taxable benefits; and

(e) since the funds would operate on a fully taxed basis, all withdrawals and commutations would be ended by equating any such payments with all others.

Special treatment would be required for unfunded

schemes. The grant of a definitive deferred pension right would give rise to a benefit assessment, on a scale to be determined: true ex-gratia grants would be taxable only in the year of receipt, and deductible by the grantor only in the year of actual payment.

An exact calculation of the impact of such a change requires a more detailed statistical base for current levels of contribution. For this analysis it is assumed that contribution levels remain unchanged and that:-

(i) total contributions, by employers and employees, are £17 billion per annum, (they are shown as £15.8 billion for 1983 in the Government Actuary's survey[5], equivalent to over £19 billion in 1988 prices. Lowered contribution rates to reflect the well-publicised problems of surplus, are unlikely to have reduced the total by more than £2 billion);

(ii) contributions by the self-employed are £1.25 billion: as is well known, this is far below the potential figure since many self-employed do not or cannot afford to take advantage of the full reliefs available;

(iii) the grant of rights in unfunded schemes would be valued as equivalent to contributions of £4 billion: over 3 million employees are believed to be covered by unfunded pension arrangements, often on a generous index-linked basis, and one quarter of the contributions paid to funded schemes is a reasonable minimum estimate;

(iv) commutation payments are running at some £3 billion per annum (they were £2.350 billion in 1983 and IR Statistics 1987 put the cost of relief at £1.1 billion, implying taxable payments of around £3 billion).

Adding these four items together demonstrates that such a new approach to taxing pensions would *increase the income tax base by £25 billion per annum.* (And if contribution levels were to fall as a result of the change, taxable profits of companies would be increased, so that the tax take would at worst be unchanged.) Assuming an average tax rate at a little over the standard rate, say 28%, the true cost of income tax relief is put at £7 billion; by contrast mortgage interest relief now has a cost (at current interest rates) of just over £4 billion.

This excludes any additional cost for capital gains tax reliefs. Revenue Statistics have consistently declined to give any figure for the cost of exemption from capital gains tax for approved pension schemes. But it may be assumed that existing funds, with annual sales of securities subject to gains tax of at least £50 billion per annum, would be making capital gains of at least £15 billion per annum: although such gains represent only £1000 per member or deferred member, they represent a major tax shelter for the higher paid. It would be some time before new taxable funds made substantial capital gains but the present yield gap between equities and bonds is an indication of the level of capital growth assumed by the market. A true calculation of gains tax costs depends on the basis of levying capital gains tax in a reformed tax system.

Arguments against this approach, and counters to them, are to be found in Appendix C.

The prize

This can be very briefly stated. Any politician must see that enlarging the taxable base for income taxes by up to £25 billion per annum provides opportunities for radical reform beyond the normal tinkering of an annual Budget; it could allow the abolition of some of the existing taxes and reliefs which act as barriers to personal ownership and tilt the playing field out of level. In an ideal (but possible) fiscal world, saving and spending are treated alike and *this* saving does not attract *that* privilege.

The first charge must be to abolish the higher rate of income tax altogether, if only because the gravest impact of the change in the tax treatment of pension contributions would be on the highest earned incomes – a senior manager might find his taxable income rising by 40% or more on a proper allocation of his employer's contributions. Such a change also opens the way to levy employees' National Insurance contributions on all forms of income, earned and unearned, and without upper limit. Higher rate income tax will probably raise only about £1.5 billion in 1988; the balance of savings will be available to make a major reduction of income tax, well below the 20% presently set as the target for this administration.

Detailed calculations depend on figures which are not publicly available, so that the following calculations are illustrative only. The total income on which tax could be charged (allowing for the increase in the taxable base arising from the pension changes) is about £350 billion; from this has to be

deducted the impact of personal allowances (£70 billion), mortgage interest relief (£20 billion) and other, minor allowances (£10 billion). Note that this is the reduction in the taxable base attributable to these allowances; the actual 'cost' is described as a little over the basic rate as a proportion of these gross sums.

Income tax in 1988/89 is estimated to yield £42 billion, employees' NICs about £14 billion; raising £56 billion (ie, on a revenue-neutral basis) from a taxable base reduced to £250 billion requires a total tax rate of 22.5%. This could be described as a 15% income tax, to meet the general needs of law and order, defence, etc and a 7.5% Social Welfare Tax, primarily dedicated to State pension provision. Description of such a percentage as a Social tax would bring home to people how much 'free' welfare costs them. Since the reform is revenue-neutral, the nation as a whole is (in budget language) neither a winner nor a loser.

With that reform accepted, the way is opened for the next major reform – *a truly simple tax system with no allowances whatever;* just as VAT is levied on all expenditure, the new income tax would be levied on all personal income. The onus would be on the payer to deduct tax on all payments of income, so that avoidance becomes virtually impossible. The absurdities of the poverty trap on marginal incomes are eliminated, there are no PAYE coding notices, no separate treatment of married couples, the Inland Revenue computer becomes largely redundant and its hard-pressed officials better able to devote their time to their proper task of enforcement. The number of man-hours spent on personal tax returns (estimated as up to 100,000 man *years* per annum), and the talents of tax accountants and inspectors, could be devoted to more productive uses. Additional resources would be required to raise the State pension, and the needs of those on very low incomes would be met by specific grants adjusted to their need (a means-tested negative income tax).

At this level of simplicity, the calculations are more straightforward. An extra £20 billion might be added to the taxable base due to the elimination of the black economy – in which case a 10% income tax plus 7.5% Social Tax yields £65 billion on a taxable base of £370 billion, providing an extra £9 billion of government spending to increase State pensions and compensate losers. Simple arithmetic, rather than an army of

Inland Revenue officials and accountants, would thereafter determine the necessary level of tax.

Capital Taxes

There would still remain the panoply of taxes on capital – a formidable barrier to wider ownership. Stamp duties (yielding £2 billion), Gains tax (even in its allegedly simplified form, yielding £1.9 billion), and Inheritance taxes (yielding £1.0 billion), altogether provide under £5 billion. But they are a maze on which much ingenuity is devoted to minimise their impact. Their effect is diverse. Stamp duty on houses discourages a form of investment which all agree should be encouraged and, through the market-makers' exemption, preserves the monopoly of the Stock Exchange in listed securities. Gains tax is levied now only on real gains, and with an annual exemption, but still requires complex calculations. Inheritance taxes choke the natural instinct to leave a better world to the next generation; and discourage the maintenance of family control of enterprises large and small. A full discussion of capital taxes is outside the scope of this paper ; but after the simplification of income taxes, the next target must be taxes on capital. A simple, equitable gains tax at the combined Income and Social Tax rate of 17.5%, levied on all types of gain realised within a given period, could be designed to yield £5 billion, ie, less than 1% of net financial wealth held by the personal sector.

The boon of fiscal reform

The reforms which this paper proposes give prizes to all. At the tax rates suggested most special tax incentives do not need to be repealed; they simply wither away. Who would mourn for retirement provision relief, or for BES, or for unemployed tax experts, if the alternative were the abolition of all personal taxes on income and capital, except for a low single-rate Income and Social Tax and a genuinely simplified gains tax? What politician could be blind to the appeal of such simplicity? What Party would win the support of the electorate if it threatened to re-instate them?

At least let the choice be clearly presented to the electorate. A Bonfire of Controls was the successful election cry five years

after the War. A Bonfire of Butterworths (the tax text books) would be splendid to behold before the next election; and the electors would be full of wonder and approval.

3

The high road to wider ownership

Pensions and tax reforms are not to be seen as ends in themselves, but only as necessary steps towards the prime political and economic goal of wider ownership. Something must therefore be said in conclusion about the philosophical basis which underlies the specific recommendations in this pamphlet. No doubt the commitment of the author, and of the Group with whom he serves, is apparent. Wider ownership is the key; and without a constant drive towards this goal we shall not preserve our freedom. But what may not be so well known is that, for all this Government's avowed espousal of this cause, and for all the success of its privatisation schemes, the trend is still, and massively, towards indirect ownership. Reversal of this trend would be the principal justification, as it is the principal objective, of this paper. First of all we must ask ourselves:-

(a) Is this trend towards indirect ownership one which the individual really wants?

(b) does it pose threats to acceptance of the most important justification of capitalism, the dispersal of economic power?

(c) is it so biased by fiscal privilege that the tax system can no longer stand the strain?

(d) do these proposals, while retaining the skills and cost efficiencies of professional investment management, at the same time give the individual a greater sense of personal involvement?

For a generation or more the concept of extending the ownership of property (using that word in its widest sense to cover all forms of asset) has been supported in theory, but neglected in practice. Now, with a fresh emphasis on 'the enterprise culture', wealth creation takes the centre of the stage. But wealth creation can be seen as a valid economic process if, and only if, wealth itself is distributed, through direct ownership, in what is perceived to be a fair manner: and it must be widely available, for immediate spending or saving, by individual consumers. Wider ownership offers not only the best opportunities for economic growth, but also the fundamental

safeguard of democratic liberties.

However, the transition from acceptance of these basic attitudes to implementation remains surrounded with a variety of barriers. One might have hoped that politicians would have recognised changing attitudes and done all that was possible to eliminate these obstacles.

A study of any primitive society, preoccupied with the ownership of land or animals, or of the acquisitive instincts of a growing child, should have been enough to demonstrate how fundamental is the human aspiration for ownership. As ownership is extended throughout a society, the power of patronage exercised through consumer decision is dispersed and the foundations of an open society are strengthened. In every way, the prospect of ownership offers hope; and it is a prospect not only to the aspiring millionaire on the stock market, but equally to the young entrant to the job market. So ownership must be recognised in its true position as a prospect for all, a key political requirement, a commander of the popular vote.

Not everyone agrees, of course. From Plato to Marx and modern socialism, there have been many who urge the wisdom of allowing a central authority to gather together the individual's pot of wealth and redistribute it according to need. Only such a central authority, it is argued, can develop sufficient wisdom and discretion to perform this task. Put thus crudely its absurdity is obvious and history demonstrates its inadequacy: the task is impossible and history shows that concentrations of power always become unacceptable. But there are variations of this approach, put forward in all integrity by those who normally speak most proudly of the benefits of personal freedom and choice. Consider, for example, the argument of the 'good employer'; since an individual cannot be trusted to provide for his family or his own retirement, it is said that it becomes the positive obligation of the State, or an employer, to set aside such a provision on his behalf. Others argue that the opportunities for fraud and misrepresentation at the personal level are such that regulation and supervision of markets must be imposed, which force the individual into the hands of the expert or the institutional manager. Paternalists, crypto-socialists and centralists come in many forms: but often enough these statements, appearing to take a high moral view, are merely the basis for protecting an existing position. There is nothing more plausible than arguments of apparent integrity concerned with protecting an entrenched interest. They must always be tested against the main beliefs of those who put them forward and challenged for what they really are, a derogation from the consumer's freedom of choice.

But ownership alone is no longer a sufficient aim. Those who rely on Adam Smith's *Wealth of Nations* for their support of the capitalist system should never forget the thinking in the second part of his trilogy, *Moral Sentiments;*- 'there are evidently some principles in man's nature which interest him in the fortunes of others and render their happiness necessary to him'. Unless ownership brings with it a sense of personal responsibility and charitable duty, of using assets with proper regard to their value, the case for dispersing ownership will be imperilled by those who can point to examples of foolishness, profligacy and waste. Yet using such examples is not really an argument against widening ownership, but rather for encouraging it in order to give greater opportunities for developing sense of responsibility. Such responsibilities cannot be shrugged off to trustees and institutions. Let us repeat:-

(a) Ownership provides the framework for human dignity and independence: it should be a key objective of the economic system.

(b) Ownership, to be effective, must be diffused as widely as possible, and thus become a central concern of the political process.

(c) Ownership must be as personal and direct as is possible, encouraging both a sense of thrift and duty to society.

(d) Ownership is not in conflict with care. For it provides the stimulus for wealth creation which generates the resources needed for care.

Anyone who agrees with these four themes must now be ready to test how far wider ownership is actually being achieved.

Ownership in Britain – Facts and Trends

Given the importance of ownership, it is surprising that the information on the personal sector's holdings of assets receives so little attention, (though partly this is because complete data is not accessible). For over three hundred years attempts to

measure personal wealth in Britain have been made, culminating in the Diamond Royal Commission and their voluminous reports in the 1970s. These reports had a social aim, being concerned primarily with the re-distribution, not with the creation, of wealth. Even so, different ways of allocating accrued pension rights made a major difference to the calculation. For example, in 1980, the most wealthy 25% of the adult population were estimated to hold over 80% of marketable wealth. But this fell to 58% when accrued pension rights were included. Naturally, the value of pension rights depends on the age of the beneficiary. The distribution of wealth is bound to reflect the human instinct to acquire assets over a lifetime of work,and to provide a decent sum, whether for retirement or to pass on to heirs. The personal sector's wealth can also be gauged by reliance on the Inland Revenue statistics, which use the net capital value of deceased estates as their basis (and are questionable on that account). For recent years, the fullest data is found in CSO's Financial Statistics (Table S.2, published only each February). See Appendix D.

Here are some of the conclusions which study of this Appendix suggests:-

(i) Housing remains the personal sector's most important asset, but has increased by only 4.5 times over the decade; despite the publicity given to prices, housing has not become a very much greater proportion of personal wealth. In round terms, during this period the percentage of owner-occupation rose from 58% to 67%, so that on a truly comparable basis housing is still responsible for 50% of net personal assets.

(ii) Of financial assets, the highest rates of growth come under the heading 'equity in insurance and pension funds': but the actuarial problems of pension fund valuation are such that considerable under-statement is almost certain. In this decade alone, the value of the equity of the personal sector in pension funds and insurance companies has grown nearly eight-fold, from 41% of net financial assets to 70%, and now represents around 25% of total net wealth. And there is no evidence to suggest that the dominance of retirement provision will not continue to increase. The Institute for Fiscal Studies has projected an annual inflow into funded pension schemes alone of £20 bn per annum, at 1984 prices, for the next 40 years, with no sign of deceleration of that growth. The IFS comment that "this growth reflects, in large measure, the fact that the sector is a considerable way short of maturity"[6]. Something of an understatement? (See Chart 2 on page 48.)

(iii) This evolving pattern of wealth ownership is inevitably mirror-imaged in the decline in the direct holdings of ordinary shares. Statistics for holdings of listed equities are documented in the Stock Exchange's Survey of Share Ownership[7], which examined the distribution of shareholdings in 1963, 1969, 1975 and 1981: the two selected intervening years confirm the trends shown between the two extreme years. Between 1963 and 1981 the percentage distribution of shares held by persons fell from 54% to 28%, (a rate of decline which would have eliminated the private shareholder by the end of the century). Their decline was mirrored almost exactly by the rise of shares held by insurance companies and pension funds (from 16% to 45%). Within that total the share held by pension funds grew fastest, from 6.4% to 26.7%; their share quadrupled in these 18 years, compared to a doubling by insurance company holdings. (The market value of occupational pension funds in 1957 was only £2.1 billion; they then held under 3% of listed equities, with individuals holding 66% of listed equities.)

Some will argue that all this has changed thanks to the present Government's success in its wider ownership campaign, which is largely based on what is seen to be immediate profits from coupon-clipping on privatisation issues. And much credit is due to the Government. The number of direct personal shareholders has increased in this decade from around 2 million in 1980 to over 9 million today. Of these, up to 2 million have been introduced directly through employee share schemes, which enjoy a variety of special tax privileges or favourable terms on new issues.

But that success masks other statistics.

(i) In the five years to December 1986, the personal sector was a net seller of company securities to the tune of £2.25 billion, at a time when it was a net contributor to life assurance and pension funds of £90 billion. The latest figures for 1987 have just become available (CSO Financial Statistics: Table 9.2); even in the boom year for the Stock Exchange, net new investment by individuals amounted to only £6.2 billion (of which £5.9 billion was invested in the third quarter alone, just before the Crash); this compares with a maintained flow of £20 billiion into institutionalised saving, three-quarters of the total.

The proportion of equities held by individuals therefore continues to decline, and is probably below 20% today. Anyone with experience of company share registers will have welcomed the increase in the number of private shareholders, but also seen the inexorable growth of the stake held by the small number of their largest shareholders. The ten largest pension funds (six of them in the public sector) alone now control over £50 billion of assets, one quarter of all assets held by pension funds.

(ii) The new shareholders are capitalists in only a limited sense. Over half the 9 million hold shares in one company only, normally based on a privatisation application or an employee allotment, and only 20% hold six or more different shares, a portfolio whose spread might be thought the minimum desirable for equity risk[8]. On one estimate, the number of private shareholders with a portfolio in ten or more companies has actually fallen in the last seven years. Given the potential profit, what is most surprising is that at least 30 million adults have not been persuaded to try their hand in the stock market.

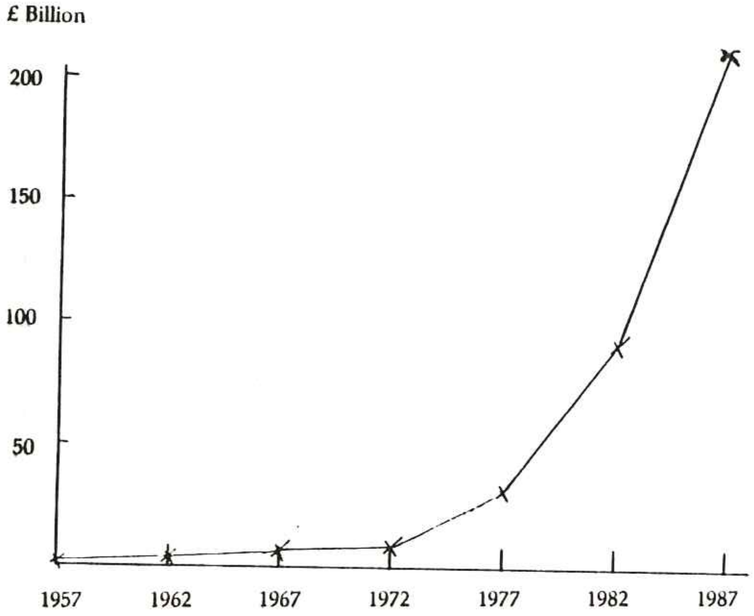
(iii) About half the sample estimated the total value of their equity holdings at up to £3,000 and the Stock Exchange estimated the average value at under £4,000[9].

A portfolio of one or two privatisation issues is not an ideal basis for wider ownership – but at least it is a platform on which new attitudes to ownership can be built. However, none of the many shareholder surveys which have been so well reported have mentioned the key fact of British ownership, the one which this paper has tackled. Albeit at second-hand, some 16 million members of pension funds own financial assets with a value of over £200 billion. This gives an average holding of £12,500, though the actual figures would range from nil for the newest recruit to over £500,000 for a senior manager nearing retirement.

Giving these 16 million people an opportunity directly to own their assets would give them a real stake in our society. Let us start, now, down the high road towards wider ownership and popular ownership, and make sure that we never turn back.

Chart II

Market Value of Self-Administered Pension Funds 1957 – 1987



Conclusion

Ownership is important and is the Tory alternative to the centralists, paternalists and socialists. But personal ownership in the UK is crowded out by the continuing growth of structured retirement provision: it dominates financial markets and diminishes the understanding of the workforce that the size of the rice bowl which will be available to support their retirement depends on their efforts, and those of their children, not on some impersonal Pensions Department. This growth is actively encouraged by fiscal privilege, with the inevitable result: more and more people may be shareholders, but they own less and less.

By giving 16 million people the opportunity to own directly the assets which are truly theirs, retirement provision contributes to an understanding of how prosperity can be achieved: by removing tax privileges for pensions in respect of future service, we can enjoy today a tax system which is fairer, simpler and a beacon to a responsible electorate.

Appendices

A.

Objections and counters to POPs

(a) *Actuaries* will argue that it is not technically possible to assess the true share of an existing fund where it has to be split among a wide group of individuals with differing personal circumstances. But it is clear that, in retrospect, liabilities can be calculated, since otherwise a discontinuance valuation would itself become impossible. And since actuarial expertise can agree on the division into appropriate shares of a fund with only a few beneficiaries, modern data management technology can divide a fund with a very large number of members. Provided the basis of valuation was published and it was seen to be broadly acceptable (and calculated annually on the same basis) employees would be satisfied: a ready-reckoner points system, allowing for salary changes, length of service, marital status etc, would adequately assess personal entitlements.

(b) *Fund managers, and pension fund trustees* will argue that pension fund investment policy is dictated by the long term and should not be influenced by possibilities of annual withdrawal. But that argument is ridiculous at a time when City institutions are continuously accused of 'short-termism' and when turnover and activity, in both bonds and equities, is continuously rising. (Precise definitions are difficult but all recent surveys have shown annual stock turnover by pension funds in British equities at least doubling over the present decade, up to around 60%: all other categories, overseas equities, fixed interest and index- linked, are now over 100% per annum). If these statistics do not invalidate the argument, it can readily be met by insisting that the portfolio of those who choose a segregated fund should continue to be managed, on a unitised basis, by the existing Trustees as an adjunct to the main fund for a limited period. A more serious criticism might be that individuals have shown themselves to be more passive investors than institutions, and that the dealing structures and facilities in the City have been built on the expectation of increasing turnover. That argument must be decided elsewhere, with the Inland Revenue as an interested observer of the trading activity of pension funds: but increasing turnover and long-term investment attitudes by definition are irreconcilable. Analysis of equity turnover should start by asking the question – what should be the anticipated retention period, on average, of an investment? Personal holders might suggest an answer of ten years: but on this basis even the lower market turnover levels of early 1988 are far higher than would be consistent with long-termism in portfolio management. Industrialists should welcome wholeheartedly any proposals which give a more stable background to the ownership of listed companies.

(c) *Technocrats* will argue that individuals will not understand that the capital value of their benefits may change, upwards and downwards, on the annual valuation, because a change in the personal circumstances of members alters the attributable proportion of available assets: this argument is no more than saying that transparency in pension fund policies is impossible. On that weakness alone the argument can be rejected: if the mathematics of cross-subsidisation become clearer to employees as a result so much the better. Those who do not like cross- subsidisation may freeze their share by taking their unitised proportion: and the losers from cross-subsidisation will soon emerge as the articulate majority. The long-term aim of changing the vocabulary, from the choice between final salary and money purchase schemes to the choice between defined income benefit and defined asset purchase schemes, will be achieved. Another cause of changes in capital value will, of course, arise from changes in market values: but capitalism does bring with it the penalties of failure, as well as the rewards of success: and so long as employers maintain defined benefit schemes, no-one will be forced into capitalism against their choice. It must be noted, however, that on a discontinuance valuation most schemes still show a very substantial surplus at the present time and will have assets valued at up to twice their liabilities: despite the market

re- alignment, perhaps the temptation to choose the present opportunity to become a capitalist will never be greater.

(d) *Centralists* will argue that some holders of segregated funds will be stupid, or unlucky, with their investment policies; and some employers might feel it their duty to protect the unlucky and the foolish. It is, however, assumed that the DHSS would insist on investment policies that protected minimum pensions so that even the unlucky and foolish would not become a "burden on the State". This might be relevant in respect of private sector pension provision of up to half the basic state allowance, putting Social Security demands out of reach of the claimant: but the argument cannot be applied when considering full maintenance of living standards in retirement. It is fundamental to this new approach that a year's allocation to retirement provision, if it is withdrawn into an individual's segregated fund, represents the complete fulfilment of the employer's obligation in respect of that year's service. Transitional restraints on total investment flexibility might be allowable – but only until people are educated to understand what is at stake.

(e) *Paternalists* will also want to argue that it is only final salary schemes which maintain an employee's living standard in retirement and that this has become a cardinal aim. Quite apart from the fact that final salary schemes do not normally guarantee inflation protection during retirement (a period which has become increasingly long as life expectations increase), it is a statistical certainty that most pensioners will enjoy an enhanced retirement income under these proposals, always assuming the level of contributions remains unchanged. In practice, of course, the expectation of "two-thirds salary" on retirement is not often met. Although many schemes operating on the two-thirds salary basis make no deduction for the State pension entitlement (so that a long-serving employee can achieve an aggregate pension in excess of final salary), the overwhelming majority retire on occupational pensions of much less than this. The *average* occupational pension (but including widow's pensions) presently payable is under £2,000, around 20% of average earnings: the boast of "maintaining living standards in retirement" is not yet met by actual pensions.

(f) *Employers* may argue that the proposals represent a confusion of principle between final salary and money purchase schemes; in particular, since employers take the risk of making up any shortfall in the fund required to meet pensions based on final salaries, they should be entitled in full to any surplus. Such an attitude is clearly out of line with modern thinking, particularly among the work force, and fails to take into account the principle of total remuneration costing. If it were to be maintained, it should have been far more clearly presented, and fiscal privilege for such policies would clearly not be justified. It is, however, recognised that specific agreement must be reached in advance as to how any shortfall in a final salary fund would be met by employer or employee contributions.

There is one last group of objectors, whose public criticism will be based on one of the above arguments, but whose true motives rest on their existing interest in keeping pensions complicated. It is a fundamental aim of these proposals that pension provision should be simplified and become comprehensible to the beneficiaries.

B.

Retirement Provision Relief

The precise details of retirement relief have often been set out, but many laymen are unaware of their full extent. To summarise them:-

(a) Contributions by employers and employees to an approved fund are exempt from corporation and income taxes respectively, provided an actuarial valuation can be held to justify the level of contribution. It is well known that pressure groups ensured that the valuation rules introduced in the 1986 Budget designed to limit over-funding have been established on a far less stringent basis than that adopted for normal valuations: the problem of over-funding, well documented in various studies, remains.

(b) The self-employed, and soon those who choose Personal Pension provision, also enjoy substantial reliefs, but limited to contributions as a percentage of earnings.

(c) Most importantly, approved funds enjoy gross fund status giving exemption on both income and gains taxes during the accrual period.

(d) Commutation rights give substantial tax-free sums on retirement; however desirable under the present inequitable system, since they provide the first whiff of ownership to many (albeit late in life), these rights are recognised as an anomaly, indeed a 'much-loved anomaly'. They provide the unique double privilege of tax deductibility on entry and tax exemption on payout.

(e) The only effective constraint is the limitation of benefits, to two-thirds of final salary (as may be generously determined) in the case of defined benefit schemes. No such limits are placed on defined contribution schemes.

Unfunded pension commitments do not, of course, have the advantage of gross fund status during the accrual period: but since beneficiaries can obtain a similar scale of ultimate benefits, the effect is broadly similar. Indeed, the origin of many funded occupational schemes was to match the benefits of unfunded civil service pensions.

Curiously, however, National Insurance contributions, designed to contribute towards the basic retirement provision which all applaud, do not enjoy the privilege of tax deductibility: and those contracted into SERPS do not enjoy tax relief on their higher levels of contribution. The effect of high marginal tax rates on lower levels of earned income has already been noted. But perhaps the ultimate absurdity comes from the basis of calculating allowances for additional voluntary contributions, with the result that those in non-contributory occupational schemes effectively enjoy higher levels of deductibility than those in contributory schemes.

C.

Objections and counters to fiscal proposals

There are four possible arguments against adopting the new fiscal approach which has been outlined:-

(a) It will be said that under the aggregate funding rate used for final salary schemes it is not possible to allocate to each individual a precise amount for the employer's contribution. It would, of course, be quite acceptable that the aggregate funding rate itself should be used as the basis for calculation. Such a device is already used when companies show the pension contributions made for Directors: the Companies Act requires the disclosure of "any contribution paid in respect of him" under any pension scheme and accountants have been happy to approve accounts using the aggregate rate. The basis has already been sanctioned by custom and practice.

The likelier result, however, would be that employees came to understand the effect of cross-subsidisation inherent in a final salary scheme when it became evident in their tax bill: and that they would insist on money purchase arrangements, where the allocation of contributions is straightforward. They would see that pensions were part of salary costs and that there was flexibility in choosing between a company scheme or using the contribution towards personal provision. In due course, far more flexible salary arrangements, on the so-called cafeteria system, would become the norm: it would be all one to the employee whether he accepted wages or pension contributions.

(b) It is also argued that it would be wrong to charge individuals with a tax liability today in respect of a benefit which may be deferred for up to 40 years. But the benefit is received today, in the form of much lower tax rates: and the more that pension costs are seen as part of normal remuneration, the greater the argument for treating the contribution as a taxable emolument. It is on that argument also that the definitive grant of an unfunded pension right is treated as an emolument in the year of grant.

(c) Companies might also tend towards pay-as-you-go pensions on a truly unfunded basis rather than the establishment of separately funded schemes. This makes no difference to the advantages of a wider tax base. The change in fiscal treatment is likely to lead to a reduction in the scale of structured pension funding, accompanied by an increase in personal saving: the obvious choice for companies would be to fund for a modest enhancement of every employee's retirement on an equal basis, leaving the higher paid to make their own provision as they chose. The fiscal change would have triggered the ideal three-tier arrangement, well-supported by the CBI and other employers:- a basic state pension, some enhancement for all employees based solely on length of service, and true flexibility for personal provision.

(d) Those involved in the capital markets may choose to argue that the flow of savings on which new industrial development depends will be changed. This misunderstands the nature of savings flows. The basic assumption is that employers will continue to contribute to pension provision at present contribution rates, and may require employees to match such contributions in line with present arrangements. If this happens, the only change is that the investment income of new funds would be subject to income tax and individuals would need to create personal savings to match this loss: in year one the total involved would be less than £.25 billion, well within normal margins of consumer change. If companies were to reduce pension contributions and not distribute the savings to employees, they would both pay more corporation tax and have higher retained funds for investment.

As noted in c) above, the ideal solution would be for companies to fund a general pension provision giving all employees an equal and modest enhancement of the State pension, regardless of their salary scale, and allow higher-paid employees to fund additional flexible savings out of after-tax income. True fiscal neutrality would have been achieved: a free market does not distort choice between saving and spending and the individual must be educated, over time, to learn the consequences of premature squandering. It must also be emphasised that about half the working population are not presently members of occupational schemes and have needed to rely on this philosophy of thrift for many years past.

D.

Distribution of Personal Wealth 1977–1987

Holdings at Year-End (£ billion)

	1977	1982	1985	1987 (est)	Compound Growth Rate % 1977-1987
Physical Assets					
Housing	166.3	378.5	559.2	755.0	16
Other	96.3	159.4	190.3	230.0	9
Financial Assets					
Cash, Deposits, etc.	68.4	127.9	177.7	210.0	12
Ordinary Shares	29.3	43.1	65.3	75.0	10
Equity in life assurance and pension funds					
Self-administered	28.7	87.0	157.4	210.0	22
Managed by insurance companies	28.0	68.7	115.2	140.0	17
Other financial assets	37.8	77.5	110.5	130.0	13
Financial Liabilities					
Housing Loans	33.2	76.2	126.1	170.0	18
Other	21.5	50.0	77.8	95.0	16
Net Wealth	400.2	815.9	1171.9	1485.0	14
Life Assurance and Pension Funds as % of Net Financial assets	41.3%	56.0%	64.6%	70.0%	
Housing as % of Net Wealth	41.6%	46.4%	47.7%	50.8%	

Source: for 1977, 1982, 1985 – CSO Financial Statistics Table S.2; for 1987 – extrapolated and estimated

E.

Overseas comparisons

Comparisons with overseas practice are always dangerous, and any figures quoted are subject to the impact of volatile exchange rates and market conditions. Other countries have different expectations as regards the funding of public sector pensions, or the treatment of pensions in payment as pay-as-you-go obligations. But those who argue for allowing the status quo to continue in Britain must recognise that the extent of dominance of funded retirement provisions is almost unique to Britain. While it is recognised that the figures below are tentative, the main point is clear: *in Britain, pension funds represent a much higher proportion* of personal savings than in other countries. Countless studies could no doubt be mounted to examine the detail and provide fuller analysis, but this would be seen only as a delaying tactic.

The following table estimates the annual growth rate of funded private pensions and the proportion of National Income that existing funding represents:-

	Growth Rate %	*Funded Assets as % of National Income*
Britain	23	60
USA	14	46
Japan	21	20
Australia	19	16
West Germany	8	7
France	16	5

Source: Economist, 8 November 1986: Survey p 4

This evidence is reinforced in a recent major comparative study on pension funds in industrialised countries[10]. One analysis there shows the proportions of household savings distribution over the years 1966 to 1984, with similar results to the table above.

	Life Insurance & Pensions		*Equities*		*Bank Deposits*		*Other*	
	1966	1984	1966	1984	1966	1984	1966	1984
Britain	23	48	31	12	37	38	9	2
USA	20	24	38	24	27	41	15	11
Japan	12	14	12	5	62	62	14	19
West Germany	20	22	6	4	68	58	6	16

It is clearly absurd that Britain's pension funds should be triple the claim on future national income as compared with Japan, a country with a high savings ratio: and there is no obvious benefit to the UK from a stock market which is capitalised at three times that of Germany.

Funding future pensions is, of course, purely a bookkeeping entry and a funded pension right, whatever the assets in which it is said to be invested, is no more than a claim on future wealth creation. That claim can be transferred overseas by the purchase of overseas assets: but the merry-go-round of international diversification by pension funds came to an abrupt halt when it was found, in October 1987, that all markets collapsed together. There was no obvious advantage, except to the commission driven global equity salesman, in British pension funds buying overseas securities if those purchases were matched, in whole or in part, by equivalent purchases of British equities or bonds by overseas funds.

It is a further reflection on the disproportionate scale of British pension funds that their overseas assets are greater in absolute terms than those of US pension funds; they represent about 40% of all global diversification by pension funds. Such international exposure is more properly the role and decision of the personal saver and should not be delegated to the institution responsible for retirement provision.

It is, of course, accepted that all major countries offer tax incentives in varying forms to pensions and other forms of saving. But, since retirement provision is so dominant, Britain is unique in allowing retirement provision tax relief to represent such a major distortion in financial markets. At a time when tax reform is being seen as a necessity (and a vote-winner) Britain has the opportunity to signal a new era.

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