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The Fowler Inquiry into Provision for Retirement and the Pension Reforms of 1986

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My task in the next quarter of an hour is briefly to describe landmark reforms which reshaped our pension system in 1986, and map out the process that led up to them.

Until 1986, for most employees, pension provision above the minimal Basic State Pension was through one of two routes. About half the workforce made contributions to an occupational pension. The other half was in the State Earnings-Related Pensions Scheme (or SERPS), the unfunded pay-as-you-go scheme inaugurated in 1978 by Barbara Castle (with the tacit support of the Conservative Opposition).

After 3 decades of hand-wringing about the 'two-nations' in retirement created by postwar occupational pensions, there had been a widespread sigh of relief in 1978 that a consensus had been forged around a partnership between employers and the state in providing earnings-related pension top-ups to the BSP for all employees.

But that consensus was brief, not least because of the Thatcher government's fears, clearly voiced by the then Chancellor, Geoffrey Howe, to the NAPF in 1981 about the 'burden of pensions', not least

- the unsustainability of public spending promises on SERPS in a world of lower economic growth
- The cost of protecting both the BSP and contracted-out guaranteed minimum pensions against relatively high inflation,
- The danger of a rebellion by those of working age against the burden placed on them as the ratio of productive workers to pensioners declined,
  and that
- the cost of occupational pensions might prove 'too heavy a burden' for employers, and about
- the potentially distorting economic effects of large pension funds' lack of risk appetite

These interlinked fears underpinned much rethinking about pensions in the ensuing five years and in 1986, the Financial Services Act in conjunction with that year's Social Security Act, a <u>major</u> reform of the overall social security system piloted onto the statute book by Lord (then Norman) Fowler), set up a new system of mass Personal Pensions with the ability to contract out of SERPS – as occupational pension schemes could do – and provided those taking one out with a financial incentive.

In parallel, the 1986 Social Security Act made significant cuts to the future generosity of SERPS. Very large long-term savings would be delivered through adjustments including basing pension rights on average lifetime earnings rather than on the best 20 years, and reducing the accrual rate from 25 to 20 per cent.

A new system of personal pensions and large long-term cuts to SERPS were significant changes by any standard.

But, in fact the government had planned to be considerably more ambitious than this.

In its 1985 green paper, it had proposed abolishing SERPS, moving its members into compulsory personal pensions with a minimum contribution of at least 4% of earnings. And with SERPS gone, of course occupational schemes would be compromised because contracting-out would disappear.

The green paper's proposals were opposed from all quarters - not just from large employers, trades unions and the so-called 'poverty lobby' (which had been expected) but from the actuarial profession and from insurers – firms that the government was relying on to make personal pensions work and which it had assumed would welcome compulsion - but which, bluntly, didn't see a profit in selling expensive-to-service personal pensions to millions of British workers on very low wages.

Consequently, the government fell back on a compromise solution: implement personal pensions as an addition to SERPS and Occupational Schemes, provide a financial incentive through the national insurance system to people taking out a personal pension (the so-called 'bribe'), whilst implementing reforms to SERPS that would radically cut its long-term generosity and, it was assumed, thereby create a further incentive for people to contract-out into a personal pension.

The puzzle, is that the government was taken aback by the strength of opposition that greeted the 1985 green paper.

It's a puzzle because Norman Fowler had been careful to hold a public enquiry – The Inquiry Into Provision for Retirement – to build support for reform.

The Inquiry Committee, chaired by Fowler, consisted of

- Mark Weinberg (founder and director of Hambro Life),
- the economist Alan Peacock,
- Marshall Field (with us tonight but then general manager and chief actuary of Phoenix Assurance)
- Stewart Lyon (general manager of Legal and General; and president of the Institute of Actuaries), and
- Barney Hayhoe (a junior Treasury minister)
- The Inquiry's secretary was the DHSS civil servant Nick Montagu (also with us tonight).

Announced at the end of 1983, the Inquiry spent much of 1984 taking evidence.

In the process, it revealed significant worries in the actuarial profession and more generally both about the idea of personal pensions and the end of the ''partnership in pensions' consensus. The principal concerns were that

1. personal pensions would destabilise occupational pensions;
2. most individuals lacked the expertise to manage retirement savings;
3. defined contribution pensions would be unacceptably volatile and risky;
4. personal pensions managed by large insurance companies would further 'institutionalise' saving and investment, potentially reducing dynamism and entrepreneurialism;
5. and, <u>anyway</u>, there seemed to be little or no public demand for personal pensions.

Shortly, our panel will explore this disconnect between evidence given to the enquiry and the government's perception of political possibilities in the green paper, but before that I would like briefly to explore the roots of the 1985 green paper's proposals

In July 1984, the Fowler Inquiry's secretary, Nick Montagu wrote to the businessman Nigel Vinson to thank him for his input and acknowledge his key role in shaping proposals on personal pensions just set out in the Inquiry's consultative document – which proposed that

- every employee should have the right to take out a personal pension,
- that employers would no longer be able to force staff to join a company pension,
- that personal pensions should be able to contract out of SERPS, and

- that employers would have to contribute to them.

Nick described Nigel Vinson, and his colleague at the right-wing think tank the Centre for Policy Studies, Philip Chappell, as the ’onlie begetters’ of the personal pension idea, which they had set out in a 1983 pamphlet entitled ‘Personal and Portable Pensions for All’.

Essentially, Vinson and Chappell had used the technical problem of early-leavers from occupational pension schemes seeing preserved rights eroded by inflation, as a hook on which to hang a proposal to enable <u>all</u> employees to have their own self-invested defined contribution personal pension, into which they and their employer would contribute, and which would follow them around from job to job.

Most importantly, their proposal had a clear ideological agenda that appealed to the prime minister – the promotion of individual responsibility and the inculcation of capitalist virtues – for Vinson and Chappell envisaged that those taking out a self-invested personal pension would gain a direct, unambiguous and most importantly <u>personal</u> stake in British capitalism. Welcome side-effects would be that

- the power of pension funds and insurers - which the CPS saw as reservoirs of institutional power at odds with individual freedom - would be radically reduced
- a handy target for takeover by a socialist government would be removed, and
- investment would be allocated more efficiently because it would be done by individuals not institutions.

Consequently, Mrs Thatcher came to support the idea of an inquiry into how personal pensions might be implemented.

We should also, however, note her appointment of John Redwood as the head of her Policy Unit in January 1984 - tasked by her with overseeing the adoption of personal pensions, he became a vocal advocate within government of making that change as part of a more radical reform that would see SERPS abolished and its members moved into personal pensions – not least in MISC 111, the small ad-hoc cabinet sub-committee set up to handle reform.

In September 1984, for example, Redwood warned the PM that

> ‘when SERPS matures early in the next century, it will pose a major threat to the public finances of this country. Its complicated calculations linking pensions to earnings is a classic example of the public sector trying to ape what the private sector should do and can do better. So SERPS has to go.’

Redwood and his Policy Unit colleague David Willetts, assured Mrs Thatcher that SERPS abolition would receive strong support from ‘the baying hordes of the pension industry, advisers, intermediaries, investors and others’ because its replacement by personal pensions would result in ‘a bonanza of business opportunities’.

The Prime Minister ultimately agreed (despite having indicated in the 1983 election campaign that changes to SERPS would not be made) and in October 1984 the government secretly committed itself to abolishing SERPS (even as the Fowler Inquiry continued to consider alternative options).

Abolition, of course, ran the risk of leaving many employees without any pension rights other than the BSP. To avoid that, it was decided to compel those without occupational cover to take out a personal pension –a rather paradoxical policy given the underlying agenda of individual freedom, but one which would ensure the success of personal pensions.

The Treasury, including Howe and Lawson's adviser Adam Ridley, had been generally quite sceptical about the Redwood vision for pensions. In April 1985, as the government geared up to issue its green paper, there was an almighty row when Nigel Lawson (who was later to describe SERPS as a long-term 'doomsday machine') woke up to just how much its abolition was going to cost the Treasury over the short- to medium-term via tax relief on personal pension contributions. That forced a compromise in the June green paper - abolition would be phased between 1987 and 1990, but not for but those within 15 years of retirement.

Nevertheless, the reaction to the green paper was explosive.

For example, the head of the NAPF Parliamentary Committee described the proposals as 'undesirable, unworkable and destroying pensions stability', and the organisation flirted with the idea of refusing to cooperate on the technical detail of implementation.

The CBI declared itself 'implacably opposed' to SERPS abolition - and most employers' organisations thought likewise (a survey of firms found only two per cent in favour of abolition). The TUC was also adamantly opposed.

Strong doubts were also evident amongst actuaries (included the Association of Consulting Actuaries, Institute of Actuaries and Faculty of Actuaries).

Insurers, not least Legal and General and Save and Prosper, who had supported personal pensions in evidence to the Fowler Inquiry, were also highly unenthusiastic.

That left Norman Fowler extremely exposed. In October 1985, he told MISC 111 - the committee in which radical reform had been forged – that 'these reactions from bodies who would normally be firm supporters - and on whom we will depend heavily on getting new arrangements in place - lead me to think again about the path we have chosen.'

The Policy Unit complained to Mrs Thatcher that Fowler was 'trying to escape' from the deal on pensions struck in MISC 111. But escape he did. In the December White Paper on *Reform of Social Security* abolition of SERPS had given way to reduction of its benefits.

Personal pensions would still be implemented, alongside SERPS and occupational schemes, and it would be possible for their members to take out a personal pension if they wished, but their success would now depend on the attraction of the national insurance 'bribe'.

That failure to abolish SERPS and replace it with compulsory personal pensions represented a major blow to those who had pushed that strategy (most notably the Policy Unit and the CPS).

Yet, though SERPS remained, the 1986 compromise effectively subjected it to death by slow strangulation. As Eric Short, a former actuary and then pensions correspondent at the

Financial Times, presciently noted, people retiring in the next century who relied on SERPS for their pension would 'be in for a shock'.

We'll be exploring that story in a future seminar on the legacy of the 1980s.

Tonight, we explore the Fowler Inquiry and its relationship to the reforms of 1986. So without more ado, let me hand you over to our panel chair, Gregg McClymont.