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Thatcher’s Pension Reforms

Project Briefing 1, October 2014

This 3-year AHRC-funded project began work in September. It will explore reforms to Britain’s pension system implemented by the Conservatives in the 1980s and consider their longer-term consequences, not least the way in which they continue to shape present day problems and constrain options for change.

The project team

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Why the research matters

The reforms of the 1980s marked a key moment in the development of Britain’s overall system of income replacement in old age. Yet, surprisingly, we lack any detailed survey of developments in that decade, let alone an expertly-conducted historical study utilising primary sources from the period. Without understanding the contribution these reforms made to our present pension problem how can we solve it effectively? Indeed, lacking such an understanding are we are in danger of repeating mistakes made in the past? For example:

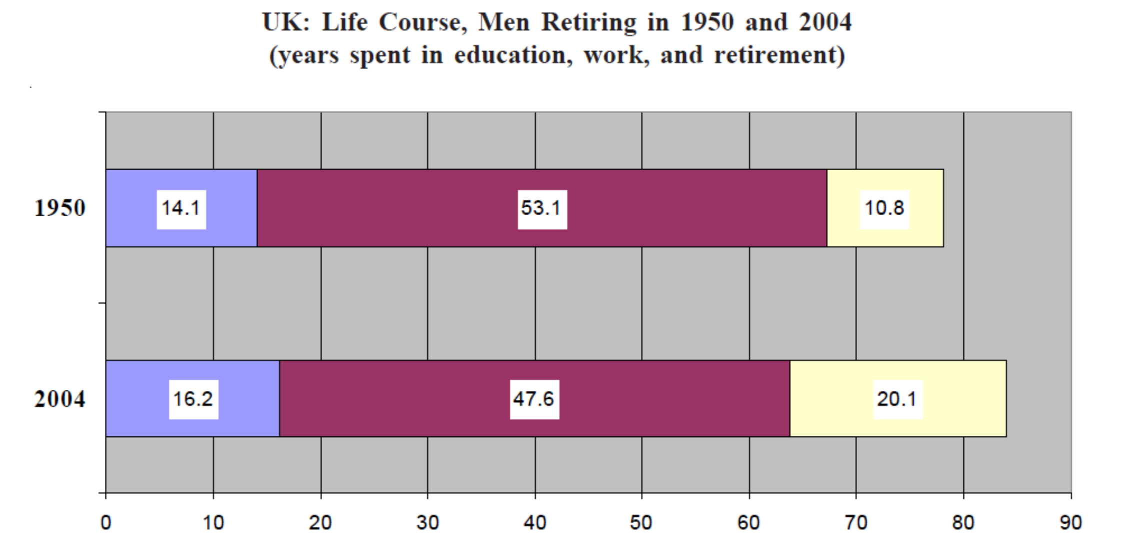
1. A persistent over-optimism about the ability and willingness of the private sector to provide decent pensions for the lower-paid;

2. An over-estimation of the ability and willingness of consumers to finance and prioritise necessary long-term saving over short- to medium-term consumption;
3. A persistent under-estimation of the power of vested interests to obstruct and/or channel policy change;
4. A failure fully to grasp the constraints placed on policy solutions by very long-term individual and collective contracts (both financial and political) in pensions;
5. A continuing under-estimation of the complexity of the political and economic cost-benefit calculations underpinning policy making in this field of policy; and
6. A consistent tendency to achieve 'reform' by tinkering and adding new elements to the system, thus making the system increasingly complex and more difficult to reform in a sustainable way.

Our working assumption is that all these mistakes were in evidence in the 1980s, as they were at other times in the history of UK pensions. By exploring them we aim to reveal their causes and consequences, and to help policy-makers avoid continuing to make them.

> ‘the bewildering complexity of the UK pension system, state and private combined, … reflects the impact of multiple decisions made over the last several decades’
>
> **Pensions Commission [The Turner Commission], First Report, 2004, p. xiii**

In 2004 the Pensions Commission noted that an array of systematic failures meant that around 9 million British adults of working age faced retirement on an inadequate pension. The unrealistic proposition that the state pension would be sufficient despite only being uprated in line with prices, combined with the significant barriers to a voluntarist solution and an ageing population, had left us facing a severe pensions crisis.[1]



N. Barr, ‘Pensions: An Overview of the Issues’, *Oxford Review of Economic Policy* (2006)

How did we reach this point? Historical enquiry allows to uncover the origins of the crisis and to understand the shape of contemporary pension provision in Britain. This research project will focus on the Thatcher government's reform of pensions in the 1980s, and on its contribution to the crisis in Britain's pensions system.

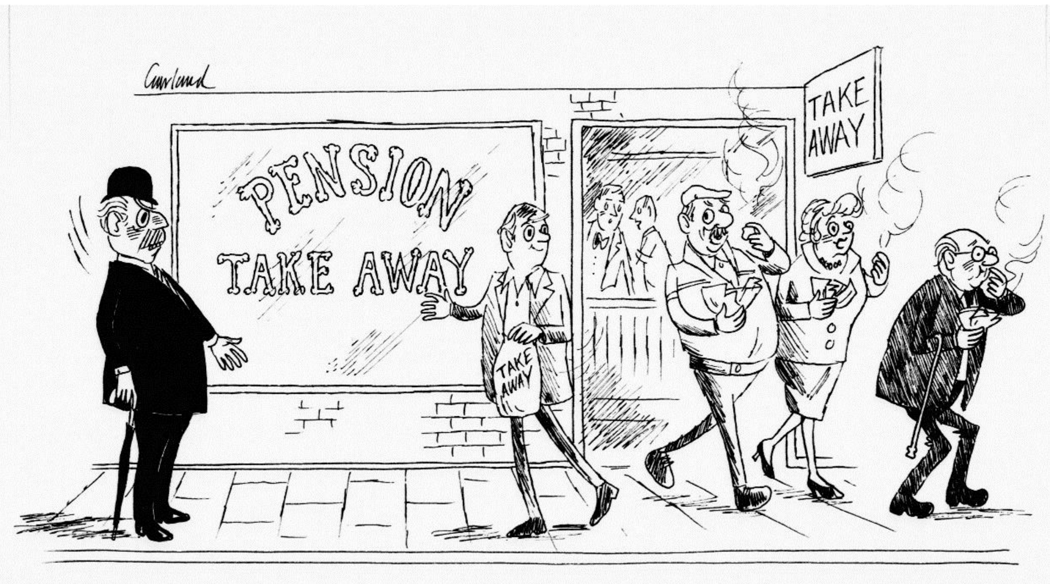
Pensions Reforms in the 1980s

The 1980s witnessed a transformation of British pension policy.[2] Over the preceding post-war decades a broad consensus had developed that a basic pension would be provided by the state, with an additional earnings-related pension provided either by the state or by employers (albeit with disagreement over the relative generosity of state provision that was desirable).[3] The consensus was perhaps best illustrated by the bi-partisan support for Labour's white paper *Better Pensions* in 1974 and for the subsequent legislation that created the State Earnings Related Pension (SERPS) in 1978.[4]

The Key Changes

In 1980 the Conservative government re-indexed benefits (including the basic state pension) to increases in prices rather than in average earnings, in an attempt to reduce costs by roughly 2 per cent per annum. Four public reviews of social security built a commitment to that culminated in the **1986 Social Security Act**. The act reduced existing state provision, and incentivised private pension alternatives:

- The state earnings-related pension was now to be based on average lifetime earnings, rather than the twenty best years.
- The value of SERPS inherited by surviving partners of contributors was reduced.
- 'Money purchase' (now termed 'defined contribution') occupational schemes were permitted to contract out of SERPS.



- A two per cent uplift to rebated tax added to all contributions to private pensions was offered to those contracting out (colloquially termed 'the bribe' in the industry).[5]

The aims of reform were three-fold: to reduce the role of the state in pension provision; to move to a funded system provided by an expanded pensions industry in a City dynamised by the 'big bang' in 1986, a change intended to increase choice, promote individual responsibility, and spur the development of 'popular capitalism' and a 'property owning democracy'; and, finally, to simplify the system.[6]

This reform agenda is commonly traced to the activism of 'New Right' think-tanks (e.g. the Adam Smith Institute and the Centre for Policy Studies).[7] The role of lobbying from financial service interest groups, as well as 'Americanisation', were also important factors. The relative importance of each will be assessed in this research project.

Limits to Reform

Despite the majoritarian system of government afforded to the Thatcher administration, there were clear constraints on the capacity for fundamental reforms.[8] Path dependent effects certainly blocked the abolition of an existing system element (pensions, with their very long contractual obligations, being generally seen as the 'locus classicus' of path dependence by social scientists).[9] The role of interest groups was also key. Norman Fowler's initial proposals (including the abolition of SERPS) were resisted vigorously by Labour, by the trade unions, and by anti-poverty campaigners. The Treasury (which feared the short-term costs), a chancellor who disliked the whole concept of compelling people to take out a personal pension and, ironically, occupational pension providers and the life and pensions industry (which did not want to be compelled to cover the many workers on very low incomes who would be relatively costly to service and generate little revenue) were also opposed.[10]

The result of such institutional and interest group resistance was that the original aims of reform were distorted. Most notably, personal pensions were installed as an addition to, rather than as a replacement for, SERPS. This increased the complexity of the overall system, but it also increased and complicated the interactions between its constituent elements.[11]

The Consequences

However well-intended, the reforms were 'disastrous', as the foremost scholar of British pensions history put it, leaving Britons with 'the worst of all pension worlds'.[12]

- The private sector failed in a sustainable way to fill the void left by increasingly inadequate state basic and earnings-related pensions. Many were left entirely dependent on declining state provision which contributed to rising poverty and growing inequality.
- A mis-selling scandal, in which the private sector sold unsuitable pension products to the public, forced the pensions industry to make compensation payments of over £11 billion. Customer confidence in the whole concept of private pensions was severely undermined as a result.

- Consumers who did take out valid personal pensions turned out to be prone to contributing too little to make up for the loss of state pension rights and/or to ending their contributions within a few years of the policy being written. This may have been due to reduced trust in their provider, or an unwillingness/inability to keep up voluntary payments, but it served to limit their pension provision.[13] High fees and poor returns served further to reduce the value of pension savings.

Research Objectives

This project will explore the roots, construction, implementation, and consequences, both intended and unintended, of the Thatcher pension reforms. It will examine the battle between ideas, interests, and institutions that took place over the Conservatives' proposals; examine the compromises that were forced in the implementation of policy; and delineate the legacy of the policy changes that resulted. As social science historians we intend for the research to be inter-disciplinary, engaging with political science, social policy, and welfare economics.

Key Research Questions

- What were the sources of 'New Right' ideas in the field of pensions? How were they generated, disseminated, and injected into the policy process?
- What debates and compromises took place within the Conservative Party concerning proposals for radical reform in pensions policy?
- What advice was offered to ministers by experts, such as the Government Actuary, civil servants, and political advisors?
- What opposition did reform proposals encounter, and how did the government respond?
- What was the impact (both national and international) of the enacted reforms in the short-, medium-, and long-term?

Research Methods

The project will be contemporary history research at its leading-edge: taking advantage of the transition to a 20-year rule for the release of official records and mining a rich seam of primary material. Primary source materials employed include:

Archive Sources: National Archives (government papers); Conservative Party Archive; Margaret Thatcher archive (Churchill College, Cambridge); Centre for Policy Studies; TUC; CBI; Life Offices Association; Association of British Insurers; National Association of Pension Funds; Institute of Actuaries; and others.

Published Material: National Insurance Fund reviews; Government Actuary surveys of occupational pension schemes; green and white papers, Parliamentary reports, Parliamentary debates, pensions legislation; official studies; political pamphlets; election manifestos; conference proceedings of political parties, trade unions, and employers' associations; newspapers and periodicals; publications by other interested parties such as the National Association of Pension Funds; National Statistics data; British Election Study data; Bank of England assessments of inflation expectation; company reports; political memoirs; newspapers and journals; etc.

Oral history: We will conduct oral history interviews with policy actors, as well as holding a 'witness seminar' to bring key political actors together to discuss the formation of policy as they remember it.

Audience and Output

> 'The project will provide a link between contemporary historical research, political science theory, and present policy debates about the future of British pensions in the twenty-first century.'

The project is aimed both at scholars and policy practitioners. In its historical research the project will build on and extend the work of historians of postwar pensions but will also engage with social scientists. To this end, the project will engage with important debates in political science about institutional development in terms of feedback effects ('path dependence') that help to 'lock-in' particular institutional configurations; the ability of incremental change cumulatively to produce radical change; and the importance of policy networks and non-governmental actors in the policy process. The project will communicate its findings to practitioners and policy actors and, in the process, help to improve policy-making.

Dissemination of findings to other academics and experts via

- A book
- A number of articles in scholarly journals
- A major conference with an associated book
- Conference papers presented nationally and internationally
- A PhD dissertation presenting results of research into the actuarial profession.

Broader impact via

- A witness seminar with full transcript made freely available
- At least one policy paper
- Shorter policy briefing notes for policy-makers and other interested parties
- A project web-site and blog aimed at both policy practitioners and the general public
- Publicity via press releases and a project Twitter feed

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