

The Opportunity of a Lifetime: Reshaping Retirement



A Summary

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Summary

Background (Chapter 1)

(Full report pages 11–16)

The 'pensions crisis' and longer life-expectancy are forcing policy-makers and employers to think again about retirement. This report looks at the future of retirement policy in Britain over the next 20 years. It takes for granted that people will need to work till they are older and asks: What will be the implications for retirement and old age? Will retirement as we know it be postponed for a few years? Or will retirement be reshaped, to become less age-related and more fulfilling?

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and more fulfilling?*

The report is part of the work of The Tomorrow Project, launched in 1996 to support individuals and organisations in thinking and gaining new insights about the future. The Project addresses a wide range of topics about the future of people's lives in Britain over the next two decades. As part of this work, we have undertaken a two-year research project on the future of retirement, with support from six organisations.

The Opportunity of a Lifetime is a study of the future rather than a conventional research report. It draws on various types of research material, including research literature, a series of consultations and a programme of focus groups.

The report is structured not around particular drivers of change, such as demographic, economic and social developments, but around issues that will have a decisive impact on retirement in the next two decades – what will happen to the labour market for older people, to state pensions and to lifetime savings for retirement?

The key issue for retirement is how to square the triangle of longer life-expectancy, adequate retirement incomes and younger workers' desire to increase their current living standards. Our starting-point is that people will resolve this conundrum by working till they are older. The recent reversal of the trend to early retirement will continue, and growing numbers will work beyond the state pension age.

As this happens, three questions will have to be tackled. How will the transition out of employment be managed? Given that Britain's labour market is likely to remain highly polarised, will the state pension system prevent those at the bottom of the earnings league slipping into old age poverty? What will be done to encourage people to increase their long-term savings?

Linking these issues is an overarching theme: how will old age be experienced in the future? Will it be more of the same, but just starting at an older age? Or will retirement be reshaped so that many more older people mix part-time work with extended leisure, and have higher incomes with which to enjoy their old age, bringing about a much more positive view in society of the ageing process?

To develop this theme, our report is structured as follows:

- ▶ **Chapter 2** asks why the future of retirement is on the agenda now.
- ▶ **Chapter 3** looks at factors that will shape the labour market for older people, and offers two scenarios.
- ▶ **Chapter 4** discusses the future of state pension arrangements, and again offers two scenarios.
- ▶ **Chapter 5** considers the future of lifetime savings, and offers two further scenarios.
- ▶ **Chapter 6** draws together the scenarios in Chapters 3–5 and presents two final, generic scenarios. It suggests how we can create the best possible future.

Up for grabs: retirement on the agenda (Chapter 2)

(Full report pages 17–37)

Retirement is a relatively modern concept, largely a creation of the 20th century.¹ Until recently there has been a trend to longer retirement, which is now being questioned. Lower fertility rates will reduce the size of the working population, making it harder to fund state pensions and other benefits for older people; later retirement is an obvious part of the solution. People are working for fewer years but retiring for longer, which is financially untenable; again, later retirement is an obvious answer.

Tackling poverty among older people has become a political priority and will remain so because of Britain's polarised labour market, but the current solution – means-testing – is unpopular; later retirement in return for a higher state pension for all is the most realistic alternative. Many people will not have saved enough for their retirement if it lasts for as long as it does now; they may have to postpone retirement instead. The Government is starting to make it easier for people to stay on at work.

Finally, retirement is on the agenda because over the next 20 years we will have an opportunity to transform how we think about it and to improve the quality of life

for older people. Instead of our lives being divided 'horizontally' on the basis of age, for many people they are becoming more 'vertically' sliced, with transitions – between work and learning, for example – at many different ages.

A key difference is that individuals have greater choice over these transitions. Although choice is severely constrained for people on lower incomes, living standards are likely to continue to rise, which will expand choice, to an extent, even for them.

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'Liquid lives' could make imposed retirement at a certain age a thing of the past. Might traditional retirement be replaced by greatly expanded choice and by a dramatic shift in how old age is viewed – as a period of human flourishing before a final stage of dependency?

Fettered or freed? Work in later life (Chapter 3)

(Full report pages 39–62)

The pressure on workers to retire later will mount, but how will employers respond? Will they simply postpone retirement, forcing older people to work till they drop? Or will they introduce more flexible forms of employment, tailor-made to the needs of older workers?

Change will not be easy. Today's concept of retirement is deeply entrenched and will not transform overnight. Many people still see retirement both as a reward for hard work and as a right to an extended period of leisure. This view is reinforced by the experience of many older workers, who often find jobs stressful and exhausting – an experience that is likely to persist.

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Encouraging more flexible employment, with work lasting till later in life, could be seen as chipping away at the right to retirement and damaging to older people's health, resulting in strong resistance. At the same time, age discrimination by employers could further entrench current patterns of employment by older workers.

However, employers will also have to respond to four pressures in the labour market.

Drivers of change

Legislation is due by 2006 for equal treatment in employment on grounds of age, including the likelihood that compulsory retirement ages (at least up to 70) will be outlawed. The form of the legislation and the manner of its implementation will help to determine whether retirement will be postponed or reshaped. Pressure may build within the EU for further legislation to encourage employment by older workers.

Skill shortages, which loom in many UK sectors, may be a second spur to a different view of retirement, as parts of the economy become more labour-intensive, technology slices away fewer jobs than expected, the demand for skills rises, the supply of young people entering the workforce begins to tail off and skill mismatches persist. Employers may respond by investing in labour-saving equipment or by recruiting more immigrant workers, but the recruitment of older workers will be their main strategy. How well will employers respond to older workers' needs?

The aspirations of older workers will be important. They will be influenced by the continued expansion of choice (not only for the better-off, but for those on lower incomes as living standards rise), by caring commitments to relatives and by the likelihood that older workers will want employment which is less demanding but still worthwhile.

Will attracting older workers be seen as costly and difficult, or as vital for competing in tighter labour markets?

Commercial constraints may make it difficult to create high quality flexible employment. These will include the size and location of the business, increasing consumer demands and heavy competitive pressures on costs. Will attracting older workers be seen as costly and difficult, or as vital for competing in tighter labour markets?

Two scenarios

Retirement postponed. In this scenario, employers respond with 'more of the same' over the next 20 years. They meet the growing economic need for people to work into their late sixties by effectively postponing retirement rather than reshaping it. Older workers acquiesce, despite their health concerns, because they need the money.

The public retains its deep-seated attachment to retirement as a right. Age discrimination at work remains deeply entrenched. Most employers remain cautious and unimaginative. Older workers end up remaining full-time in good quality jobs, if they have them, or trading down to part-time, more marginal employment, which narrows the opportunities for lower-paid workers. Retirement is still broadly age-related, though at a later age, and the routes into it remain inflexible.

Retirement reshaped. In this scenario, retirement is not postponed but reshaped, so that it is far less age-related. Routes out of work are more flexible – driven by a generation of older workers who have lived fluid lives, value choice and demand more flexibility in retirement, so that they can continue work but without feeling too stressed and worn out. Skill shortages have become so acute that employers are clamouring for older workers. Employers respond by creating more flexible patterns of work.

By 2025 the traditional concept of retirement has begun to change. Ageing begins to be seen as an opportunity for fulfilment rather than the continuation of punishing employment. Retirement is becoming less age-related and the pathways out of employment more varied. Although a substantial proportion of people still leave work in their late sixties, a growing minority continue into their early seventies –

and some even later. It is too early to say that retirement has been totally reshaped, but the way retirement is framed has changed.

Patching up or lasting reform? The future of the state pension (Chapter 4)

(Full report pages 63–89)

The state pension system makes a statement about the nature of retirement. It gives younger people a rough idea of when they can expect to retire and, by being strongly age-related, props up a traditional view of retirement. A rewarding old age requires an adequate income, but many of today's pensioners are in poverty. Will the state pension promote a less age-based and more fulfilling view of retirement in the years ahead?

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Drivers of change

The present state pension system is under challenge from many quarters. It is criticised for being too complex, for containing disincentives to save, for failing to address poverty adequately, for being ill-attuned to longer life-expectancy and for being costly to the tax payer. There is widespread agreement that the system will have to be overhauled at some stage.

Yet there are strong political constraints in the way. These include the long-term costs of improving state pensions when set against other demands on the public purse, fears that the benefits of improvement would go to those who need it least, opposition on health grounds to requiring older people to work longer in return for pension reform, and a lack of consensus over the desired nature of reform.

Two scenarios

More of the same. In this scenario, the Government tries to make the current system work. The State Second Pension (S2P) is made more generous for people on low to modest incomes, and the Basic State Pension remains at its current level. Both are indexed to earnings. These steps lift many pensioners off means-tested benefits.

The Government meets the additional costs from savings on the Pensions Credit and other means-tested benefits, and by phasing in an increase in the state pension age to perhaps 67, starting in the early 2030s.

Lack of consensus drives the Government to a minimalist approach, designed to keep intact as much of the present system as possible. No additional steps are taken to make state pensions more flexible as a further encouragement to phased retirement.

A flexible state pension. This scenario is more radical, though it is presented as

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the further evolution of the current Government's plans to provide a more generous enhancement to the Basic Pension, including the option of a lump sum payment to those who delay taking the pension.

In 2011, following a lengthy period of public debate, the Basic State Pension and S2P are combined into a new 'Flexible State Pension', to be phased in from 2030 and indexed to earnings. The Flexible Pension is paid to everyone, irrespective of their contribution records, on a residency basis and at a flat rate, set just above the poverty line – slightly over £100 a week for single people, and £175 for couples (2002–3 prices). Eventually, when all pensioners are covered, the Flexible Pension makes means-tested benefits for this age group largely redundant.

Individuals have increased choice over when they start to receive their Flexible Pension. They can take it any time between ages 60 and 80. The value of the pension is adjusted downward if taken before age 70 and upward if taken later. Anyone who settles for a reduced pension requires an annuity (or equivalent), which will guarantee that their retirement income, including the state pension, remains at the level of the Flexible Pension or higher.

The substantial net costs of the Flexible Pension are met by raising the state, or 'central' pension age, probably to around 70, phased in over a 10-year period, starting in the mid-2030s. People whose lifetime earnings average out at close to the poverty line receive a slightly higher pension.

The age at which the full Flexible Pension becomes payable is adjusted automatically to reflect changes in life-expectancy, with those affected notified well in advance of the date at which the full pension becomes payable.

The new Flexible State Pension supports the reshaping of retirement. It further erodes the notion that older people enter a stage of life that is strongly age-determined. It embodies the principles of choice and flexibility. It lifts the incomes of the poor, helping them towards a more fulfilled old age.

With or against the grain? The future of lifetime savings (Chapter 5)

(Full report pages 91–126)

The Government hopes that there will be a strong shift to saving for retirement through an occupational or personal pension scheme. But this seems unlikely under present arrangements.

Drivers of change

Many workers will remain reluctant to save. One reason will be that Britain's polarised labour market persists, leaving a good number too poor to save. Will those on middle to higher incomes who can afford to save for retirement save enough? Many are not doing so now.

In future, savings by middle earners will be curtailed by breaks in full-time employment (for example, to look after children), by additional financial commitments (notably paying more for higher education and other government services), by the costs, for some, of family breakdown (living on your own is a lot more expensive than with another person), by the strong allure of day-to-day consumption and by longer life-expectancy, which makes it harder for young people to imagine their old age and plan for it.

Defined benefit schemes will gradually wither away. Until now they have proved highly attractive, not least because employers carried most of the risks. But the spread of these schemes has gone into sharp reverse. They are seen as too costly and risky for employers. Employers are using the closure of final salary schemes to new members as an opportunity to cut their pension contributions to the new schemes and to transfer the risks to individuals.

Defined contribution schemes will be unattractive to many people. Mistrust is widespread following a succession of scandals and recent collapses in the financial services industry. Despite reducing costs, the industry's cost structure is ill-suited to a low inflation age, with lower nominal returns on investment. Equity-based pensions involve considerable risks for the individual, even if investments are moved into bonds as retirement approaches.

The huge range of pension products, complicated charging structures and complex tax treatments (despite the Government's proposed simplification) leave consumers confused. Has the industry ended up in the wrong business? It sells an extensive range of products when most people would benefit from a simpler range. It sees itself as selling pensions, when what most people need is regular financial advice.

In short, it provides customised pensions and standardised advice, when perhaps what most people need are standardised pensions and more customised advice.

Persuading people to save will be a huge challenge. Solutions may lie in better advice and information, including the imaginative development of pension forecasts so that they attract more media interest and comment. Another solution might be to compel individuals, employers or both, to contribute a certain annual amount to pension schemes, although this would carry high political risks.

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Alternatives to pensions may become more attractive. These alternatives could include equity release schemes through which people raise income on their homes, and inheritance.

Two scenarios

Compulsion plus. In this scenario, employers are obliged to contribute a minimum of 5 per cent of each worker's earnings to the individual's personal or occupational

pension. To encourage contracted-out workers to save more, employers are required to match the contributions of individuals up to a total of 9 per cent. So, if a person put 5–9 per cent of their salary into a pension, employers would have to match it.

Despite this new incentive, workers remain reluctant to increase their savings substantially. So in 2011, as part of the reform of state pensions, compulsion is extended to individuals (and retained for employers). The state pension age is raised, perhaps to 67. Private pensions are expected to follow suit, giving individuals longer in which to save.

Compulsion removes the need for tax relief on contributions to private pensions, which is phased out. The abolition of tax relief funds a substantial cut in income tax, making compulsion politically acceptable. Compulsion, rather than choice, becomes a key feature of the pensions regime.

Lifelong Savings Account. This scenario adopts a more flexible approach to lifetime savings – a different way of thinking about savings altogether. The Lifelong Savings Account bundles together various savings schemes that attract government support – pensions, ISAs and the Savings Gateway (currently being piloted to encourage lower earners to save) – and also brings in some new elements.

This new approach to savings is designed around the life cycle rather than around retirement alone, as is currently the case with pensions. It encourages people to

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save for immediate needs, as well as more distant ones, by acquiring 'assets' that they want now, but which can also boost income in old age. These 'assets' consist of housing, learning and old age income.

Individuals are encouraged to travel through life with a Lifelong Savings Account, into which they put contributions when they can, and from which they can make withdrawals to purchase three types of assets: property, work-related learning that will push up their income, or a pension. These purchases attract government financial support up to a ceiling, replacing the support that is given to pensions, ISAs and the Savings Gateway. They also attract (compulsory) employer support, again replacing employer contributions to pensions.

The Lifelong Savings Account is kick-started with a much-enhanced 'baby bond', perhaps financed by receipts from inheritance tax. An annual savings forecast is a further feature.

To qualify for matching contributions, the Lifelong Savings Account is held in a designated bank or building society account, but only with banks and building societies that offer financial advice independent of the sale of financial products.

We give an example of how a Lifelong Savings Account and the balances within it might look throughout a lifetime.

The scenario responds to reservations about a 'one-size-fits-all' approach to savings and works with, rather than against, the short-termism of consumer behaviour. It encourages savers to spread risks, and enshrines the values of choice and flexibility needed for the reshaping of retirement.

Travelling to the future (Chapter 6)

(Full report pages 127–35)

We pull together the scenarios in the previous three chapters into two final, generic scenarios, which provide alternative maps for policies on retirement, the state pension and savings for old age.

Two scenarios

Putting it off. Retirement is much as we know it today, but it starts later. The beginning of retirement remains age-related, but the age is merely postponed. Routes into retirement remain inflexible and fulfilment in older age is jeopardised by inadequate income. The financial preparation for retirement is squeezed into a 'one-size-fits-all' straitjacket, which ignores the fluidity and diversity of many people's experiences.

Employers are reluctant to devote management time and other resources to creating flexible work for older people. A relatively tepid approach to pension reform reinforces existing views of retirement. Inflexible savings are still the road to inflexible retirement.

Liquid lives. This scenario looks very different. Its foundations are laid during the first quarter of the century, although its main features are not fully apparent till some 25 years later.

Retirement is no longer a distinct phase of life. People can mix-'n'-match work and more extended leisure, with more numerous routes out of full-time employment. Indeed, the distinction between working life and retirement

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becomes so blurred for many people that eventually the notion of retirement itself comes into question. The financial preparation for retirement is released from its traditional straitjacket. Individuals have more savings options, backed by state and employer financial support. They can tread a more flexible financial path to a more flexible old age.

The need to encourage flexible employment becomes a policy priority. The Flexible Pension cuts pensioner poverty, enabling those on low incomes to enjoy a somewhat

more fulfilling old age. Lifelong Savings Accounts embody the values of choice and flexibility to reshape lifetime savings, so that people are more willing to save, acquire more assets and are able to use these assets to support their old age.

Our preferred future

Liquid lives would erode the dominant role of age in retirement arrangements. It would offer older people more choice and flexibility, and more opportunities for fulfilment and self-improvement. It would transform the experience of old age, and have a 'ripple' effect on younger age groups – not least by making their work more flexible: flexible work for older people would influence the terms and conditions of younger workers.

Retirement and the financial preparation for old age could be reshaped bit by bit over the next two decades, so that by 2025 the foundations will have been laid for a very different approach to later life and a more flexible, fulfilling and rewarding old age.

Even if few active steps were taken to reshape retirement, social forces could bring it about in any case. Might it not be better to work with the grain of those forces? Many of the milestones along the *Liquid lives* route are in place already, including plans for some greater flexibility in pensions, the

Government's proposals on age discrimination legislation, the new 'baby bond', the Savings Gateway scheme currently being piloted for those on lower incomes and the planned pensions forecasts.

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Endnote

- 1 We define retirement as the single, irreversible transition from paid to unpaid activity, occurring at a particular age, and requiring a combination of pension and personal savings to provide an income after the transition has occurred.