Embargo until 00.001 hours Saturday 24 June 2006

INCREASED IMMIGRATION MAY BE NEEDED TO STEM THE UK PENSION CRISIS

Up to 10 million migrant workers might need to enter the UK between now and 2025 so as to ensure that pensioners can continue to receive the basic state pension. This is one of the key finding of a new study by Professors **David Blake** and **Les Mayhew**, published in the latest issue of the *Economic Journal*.

The forecast is one of a number of possible pensions scenarios facing the UK that have been derived from a simple model of demographic projection developed at Cass Business School in London.

The essential problem is that there are not enough workers to support pensioners because we are living longer and birth rates have fallen. In 1990, there was one pensioner in the UK for every four workers. By 2030, there is projected to be nearly two pensioners for every five workers.

The government's pensions White Paper, published in May 2006, proposes re-indexing the basic state pension to earnings from 2012, raising the retirement age to 66 between 2024-26, to 67 between 2034-36 and to 68 between 2044-46.

This research finds that if the economy is well managed, if there is real growth at the historical rate of 2.1% a year and if the population grows at the rate forecast by the Government Actuary, then the state pension will be able to increase in real terms at 1.5% a year up until 2020. After this point, the contributor shortfall (arising from an insufficient number of workers relative to pensioners) will rise again and the state pension age would have to increase to 70.

Les Mayhew explains:

> 'In each of the scenarios we model, the pension contributor shortfalls become increasingly difficult to manage after 2020. A difference between our research and the assumptions in the White Paper is that re-indexing would start immediately rather than in 2012. So each year the government delays re-indexing, they relieve some of the pensions pressure.'
>
> 'Nevertheless, our work shows that the pension age needs to increase sooner than the government proposes. But once they are committed to these ages, the scope to rein back on expenditure boils down to fiscal measures such as when to begin re-linking and whether it is partial rather than total re-linking – hence government references to "affordability".'

An ageing society like the UK, which is also declining in numbers because its birth rate is too low, faces stark choices if it is going to have a credible and viable pay-asyou-go state pension policy. Credible pension policies have to be 'time-consistent' and time-consistent policies cannot pass the buck to future generations – that is, they have to exhibit intergenerational fairness.

This implies that the ratio of a society's pension bill to its wage bill cannot increase systematically. If the next generation is smaller in number than the current generation, the current generation has to:

- accept a cut in its real pensions (either relative to prices or to wages) or;
- contribute more while in work or;
- work harder or;
- work longer and retire later or;
- accept more immigration.

David Blake comments:

> 'From a wider perspective, all these things may need to occur – working longer, increases in migration and increases in contribution levels. Expecting everybody to work longer may be unrealistic as activity rates among the over-50s have hardly changed in 25 years, and to make any difference there would have to be a significant change in working habits. This cannot simply be assumed.'

The analysis shows that it is highly likely that demographic factors will increasingly dominate economic factors over next 25 years and beyond in the UK. Any realistic increases in labour productivity, in work effort or in pension contributions by the indigenous population will not be sufficient to compensate for the combined problems of population ageing and declining fertility in the long run.

It is therefore also highly likely that pensions, retirement age and immigration issues will increasingly dominate the political agenda on national resource allocation over the next quarter century.

ENDS

Notes for editors: 'On the Sustainability of the UK State Pension System in the Light of Population Ageing and Declining Fertility' by David Blake and Les Mayhew is published in the June 2006 issue of the *Economic Journal*.

Professor David Blake is director of the Pensions Institute (www.pensions-institute.org) at Cass Business School, 106 Bunhill Row, London EC1Y 8TZ. Professor Les Mayhew is director of the Risk Institute at Cass Business School.

For further information: contact David Blake on 020-7040-5143 (email: d.blake@city.ac.uk); or Romesh Vaitilingam on 0117-983-9770 or 07768-661095 (email: romesh@compuserve.com).

About the Pensions Institute

The Pensions Institute at Cass Business School was founded by Professor David Blake in 1996. As the first and only UK academic research centre focused entirely on pensions, the Institute brings together a broad range of disciplines from economics, finance, insurance, and actuarial science through to accounting, corporate governance, law, and regulation.

The objectives of the Pensions Institute are to undertake high quality research in all fields related to pensions, to communicate the results of that research to the academic and practitioner community, and to employers and trustees.