Levelling up pensions

How pension reform can boost opportunity for poorer workers and regions

ONWARD

About Onward

Onward is a modernising think tank whose mission is to develop bold and practical ideas to boost economic opportunity and strengthen communities in all parts of the United Kingdom.

We are not affiliated to any party but believe in a mainstream conservatism. We recognise the value of markets and support the good that government can do, and believe that a strong society is the foundation of both. We want to seize the opportunities of the future while preserving the accumulated knowledge of the past. We believe that most people are hard-working, aspirational and decent, but that many do not have the opportunities to fulfil their potential.

Our goal is to address the needs of the whole country: young as well as old; urban as well as rural; in all parts of the UK – particularly places that feel neglected or ignored in Westminster – by working with ordinary people directly and developing practical policies that work.

Thanks

We would like to thank Simon Oswald and Dale Critchley at Aviva for providing the actuarial calculations used in this paper. All errors and further analysis are entirely the authors' own.

Onward is a small non-profit that relies on the generosity of our donors and patrons to do our work. We are indebted, in particular, to our Founding Patrons: Martyn Rose, Michael Spencer, David Meller, Bjorn Saven, Richard Oldfield, Robert Walters, Tim Sanderson, James Alexandroff, Jason Dalby, Graham Edwards, John Nash and Theodore Agnew. Without this philanthropic support, our work would not be possible.

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Summary of the argument

Since it was introduced in 2012, automatic enrolment has proved incredibly successful at increasing the number of people saving for retirement. By simply opting workers into saving, the proportion of employees in a workplace pension scheme has risen from 46.5% in 2012 to 77.6% in 2020.

But younger workers, part-time workers, and those on low pay still miss out - because auto-enrolment does not kick in until people are earning over £10,000 a year and over the age of 22 years old. This results in a pension participation rate of just 20% for 16-21 year-olds, 41% for those earning £100-£199 per week, and 58% for part-time employees. The youngest employees - those aged 16-21 years old - are currently five times less likely to have a workplace pension as middle-aged employees.

And because lower paid and part-time workers are disproportionately concentrated in less prosperous regions, this contributes to Britain's regional divides as well.

It is time to level up pensions for everyone - by abolishing the earnings trigger and reducing the age at which people benefit from auto-enrolment to 18 years old. Doing so would help individuals and their families to save for the future, and generate trillions in capital for pension funds to deploy towards infrastructure, housing and other investments central to the Government's economic ambitions.

As this paper demonstrates the potential gains are considerable. We estimate that abolishing the £10,000 earnings trigger for auto-enrolment and the £6,240 lower earnings limit for pension contributions, alongside reducing the age threshold from 22 to 18 years old, would lead to the following benefits:

- A full-time worker on the National Living Wage would gain an extra £93,989 over a working lifetime, which would be a 60% increase in their workplace pension savings.
- Younger workers would save an extra £20,267 upon retirement, on average, from being enrolled at age 18 rather than age 22.

- A worker with two part-time jobs, each paying £190 a week, could see their pension savings triple to £297,600.
- Over the whole working lifetime of the current workforce, the total additional savings could be as high as £2.77 trillion, creating significant additional resources that could be deployed in the Government's levelling up agenda.

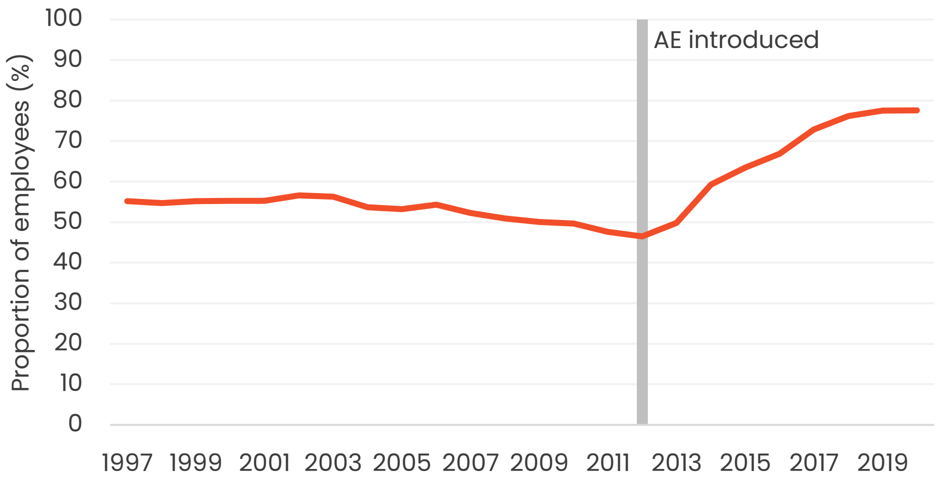
The Government has already signalled its support for these measures, by committing to review the earnings trigger, the lower earnings limit, and the auto-enrolment age. But there is no timetable for these changes set out at present. We propose that these changes are phased in over the next four years, to give businesses certainty and time to prepare, concluding in 2026.

The history and current rules around auto-enrolment

Historically, around half of employees had a workplace pension, with the proportion on a downward path since at least 2006. The Coalition Government introduced automatic enrolment in October 2012 in order to reverse this decline and nudge millions of people into saving for retirement. Under the legislation, employers were required to provide (and contribute to) a workplace pension for eligible employees by 1 February 2018, unless employees opted out voluntarily.

As Figure 1 shows below, the proportion of employees with a workplace pension remained at around 55%-56% between 1997 and 2003, before declining to 46.5% in 2012. But since auto-enrolment was introduced, this figure has risen sharply to 77.6%. It has done so across all age groups that were affected, and is broadly seen as one of the most successful policies for driving up retirement savings among younger generations in recent political history.

Figure 1: Proportion of employees with a workplace pension



However, auto-enrolment, as originally introduced, is limited. It applies to employees aged over 22 who earn more than £10,000 a year (£192.30 a week), and contributions are only paid on earnings above the lower earnings threshold of £6,240 and below the upper earnings threshold (£50,270 per year). Contributions are split between 5% of qualifying earnings from the employee (4% from net income and 1% tax relief for basic rate tax-payers) and a further 3% of qualifying earnings from the employer.

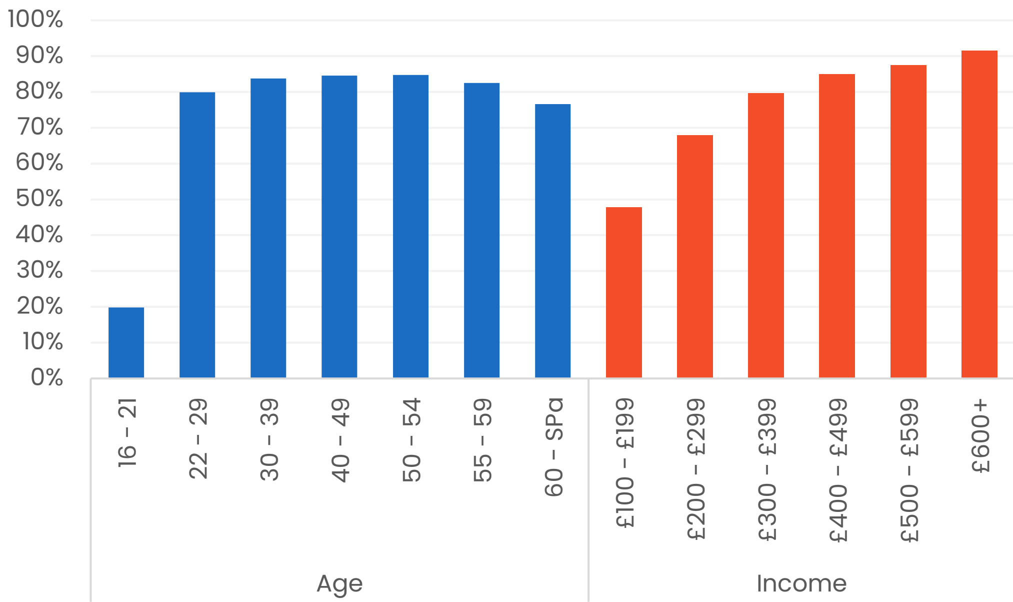
Who is excluded from auto-enrolment?

According to ONS data, in April 2020 nearly eight out of ten UK employees (78%) had a workplace pension, compared with less than five out of ten in 2012 when automatic enrolment was introduced. But this varies significantly according to both age and income.

- **Age.** The youngest employees, who are outside the automatic enrolment age eligibility, are five times less likely to have a workplace pension as middle-aged employees. Participation in a workplace pension was just 20% for 16-21 year-olds. But participation rises to 80% for those aged 22-29 and 85% for employees aged between 40 and 54.

- **Income.** The likelihood of having a workplace pension increases with income. But this relationship only holds for the private sector. In the private sector, just 41% of employees earning between £100-£199 a week participate in a pension, compared to 90% for those on the highest incomes. For context, only 8% of the lowest earners had a workplace pension in 2012 before auto-enrolment. In contrast, the lowest-earning public sector workers are just as likely to participate in a workplace pension scheme as those earning over £600 a week.

Figure 2: Proportion of employees with a workplace pension



Among full-time employees, women are slightly more likely to participate in a workplace pension than men (88% compared to 85%, respectively). This gap increases when we consider part-time workers. Whereas 62% of women working part-time workers have a workplace pension, only 46% of men participate. However, the greater prevalence of part-time work among women means that, overall, fewer women have a workplace pension (76%, compared to 79% of men).

Part-time employment has a significant impact both on pension participation and savings rates. A person working two jobs that each pay £9,000 a year would not have to be auto-enrolled in a workplace pension scheme, despite having a combined income far higher than the £10,000 trigger. Indeed, full-time employees are 1.5 times more likely to have a workplace pension (86.4%) than those working part-time (just 57.8%).

But even among those part-time workers who are enrolled by their employer, they will end up saving less than their full-time colleagues. This is because the lower earnings threshold is deducted once per job. So, for a person working two jobs, 20 hours a week on the National Living Wage of £8.91 in one job, and 15 hours on the minimum wage in a second job, they will only be saving 37% as much as a person working a full-time job on the National Living Wage. Table 1 shows that, despite working the same number of hours at the same rate of pay, the part-time employee saves only a fraction of the amount a full-time employee does.

Table 1: Weekly pension contributions for full-time and part-time workers

	Hours	Pay	Qualifying Earnings	Pension Contribution
Full-time worker				
Total per week	35	£311.85	£191.85	£15.35
Part-time worker				
First job	20	£178.20	£58.20	£4.66
Second job	15	£133.65	£13.65	£1.09
Total per week	35	£311.85	£71.85	£5.75

The case for expanding auto-enrolment to young workers and low earners

The Government has previously committed to reviewing both the age and income eligibility. Onward's analysis suggests that expanding eligibility for auto-enrolment could dramatically increase savings rates among the lowest earners and people in younger cohorts. While the data is inherently uncertain, we can make some reasonable assumptions.

Estimating the number of beneficiaries

Using ASHE data, we can estimate that there are as many as 7 million people not currently in a workplace pension, based on the fact that 22% of the UK's 32.6 million employed people do not currently have a workplace pension. Some of these 7 million people will have chosen to opt out. The rest will either be under the age of 22 or earn less than £10,000. Interestingly, this almost exactly matches the number of part-time workers, which stood at 7.4 million in 2020, down from 7.7 million in 2019.

But how many people would become eligible for auto-enrollment if the Government lowered the age threshold and abolished both the earnings trigger and the lower earnings limit? We will look separately at the numbers based on age and income.

Turning to age, there are approximately 1.3 million employees aged 18-21 and around 20% already have a workplace pension.[1] So, we can estimate that up to 1 million additional young people would be auto-enrolled in a workplace pension scheme if the age threshold was lowered from 22 to 18.

Looking at income, we can estimate, also using ASHE, that about 12% of employees earn less than £192 a week (which equates to £10,000 a year).[2] This implies that around 3.9 million people earn less than the auto-enrollment trigger. Around 47% of those people already have a workplace pension. So, as many as 2.1 million people on lower incomes could stand to benefit from enrollment in a pension scheme.

[1] House of Commons Library calculation (from request)
[2] ONS (2021) Earnings and hours worked, all employees: ASHE Table 1

Putting these figures together, we can estimate that up to 3 million people could be automatically enrolled in a workplace pension. Practically speaking, this is the upper-limit of the number of beneficiaries as there will be significant overlap between those two groups (young people and people on low incomes).

What would this do to savings rates?

Modelling undertaken by the Department for Work and Pensions (DWP) estimated that freezing the threshold at £10,000 for 2021/22 would increase the number of individuals saving into a workplace pension by 8,000. Pension participation would increase because earnings growth brings some individuals' pay above the £10,000 trigger. This would increase total contributions by an estimated £6m a year.[3]

The DWP also estimates that aligning the earnings trigger with the National Insurance Lower Earnings Limit (£6,240) would increase the number of participants by 284,000 people, increasing total contributions by £110m. Crudely, if we take this £110 million, minus the £6 million saved from freezing the earnings trigger, and scale this up by the average number of working years (25 years if the average age of a worker is 42), we can get a rough idea of what impact this might have in the longer term. Over a 25-year period, this £104m extra saving amounts to £5.54 billion in additional pension savings for the current workforce.

But these estimates seem quite conservative. We know from ASHE that approximately 22% of part-time workers earned between £6,240 and £10,000 in 2020 (we look at part-time workers because it is relatively unlikely that many full-time employees earn less than the £10,000 trigger given the national minimum wage). We also know that 80% of part-time employees work in the private sector and that 47.6% of those already have a workplace pension.

This suggests that there should be around 682,381 private sector employees without a workplace pension who earn more than the Lower Earnings Limit but less than the current earnings trigger - and would therefore be automatically enrolled in a pension scheme. Assuming that the distributional impact is the same – as per the DWP calculations – but scaling up the number of new

[3] Department for Work and Pensions (2021) Review of the automatic enrolment earnings trigger and qualifying earnings band for 2021/22: supporting analysis

participants to 682,381, the extra saving each year would be £250 million. Over a 25-year period, this would generate an additional £13.3 billion in pension savings.

To estimate the additional pension savings from abolishing both the earnings trigger and the lower earnings threshold, we use the following criteria:

- There are 7.4 million part-time workers in the UK.
- 42% of part-time workers earn less than £10,000 a year.
- 58% of part-time workers already have workplace pension.
- The median income of part-time workers who earn less than £10,000 is £6,600 a year.

Total annual saving would equal £694 million. To illustrate the long-term benefit, scaled over 25 years, this would add £37 billion to pension pots. Over a 46-year working life, an extra £131 billion would be saved in total. This gives us a rough estimate of how much would be saved by those employees (almost all will be part-time workers) whose income is lower than the £10,000 earnings trigger.

But this is only a small part of the total benefit. Although removing the earnings trigger would be unlikely to enroll many additional full-time workers, abolishing the lower earnings threshold would add £6,240 to each person's pensionable pay. The additional contributions of £499.20 per year would result in an extra £93,989 in each person's pension pot over their lifetime.

For those on low pay, this represents a massive increase in their retirement funds. A person earning £12,570 a year (the equivalent of the personal allowance for income tax) would see their pension pot double from £95,344 to £189,333. A full-time worker on the national living wage (around £16,625 a year) would see a 60% increase in their pension pot upon retirement. This change would be strongly progressive, as higher-earners on £40,000 would only see an 18% rise.

To work out the total increase in retirement funds for full-time workers, we multiply this £93,989 per person saving by the number of full-time workers (which was 23.6 million in 2020), and find that an extra £2.2 trillion would be added to pension pots over the course of a working lifetime.

We also need to factor in those part-time workers who earn more than the auto-enrollment trigger. If we assume that all of those 58% of part-time workers earning more than £10,000 gain an extra £93,989 on retirement, this would add a total of £404 billion to pension pots.

How much would be saved if the Government lowered the age limit to 18? We calculated the extra four years of pension contributions between age 18 and 21 that would be cumulated over the remainder of a person's working life. If we take the average income of 18-21 year-olds as £10,820 (the median annual income in 2020/21 according to ASHE data). The average person would save £865.60 per year, for a total of £3,462.40 over the four years between the age of 18 and 21. This fund would become £20,267 on retirement (based on an annual growth rate of 3.75% net of charges). If we multiply that by the million young people without a workplace pension, the total sum added to UK pension pots as a result of the change would be £17.9 billion.

If we add these figures together, we can estimate the maximum amount that could be added to pension pots over a whole working lifetime. In total, pension saving could rise by £2.77 trillion. As mentioned above, £2.2 trillion of this comes from full-time employees, which is unsurprising given that they represent the vast majority of the workforce. These changes would not only support today's young and part-time workers when they retire in 46 years' time, but create additional resources for pension funds to invest today, not least in the Government's levelling up agenda.

Case studies

To put this into perspective, we can look at the impact on two different individuals:

1. A person who earns £345 a week, split across two part-time jobs, would earn £17,940 a year. But because neither job is above the £10,000 earnings trigger, they would not be automatically enrolled in a workplace pension scheme. But if this was no longer an obstacle, and they were able to start saving from the first pound earned, their pension pot could be £332,701 at retirement (assuming a monthly payment of £119.60 over 50 years). Even if they were enrolled in a workplace pension in both jobs, because the Lower Earnings Limit is deducted twice (once per job) the monthly contribution of £36.40 would provide a total fund of £101,300 - only a third the size.

2. An 18-year-old starting their first job, earning £340 a week (£17,680 a year), would not be auto-enrolled in a workplace pension under the current system. But with our proposed changes, they would save £1,414 each year. Across the next four years, from the age of 18 to 21, their pension savings would amount to £6,326. At retirement, the projected value of this initial £6,326 would be £33,931.

3. A part-time employee earning £190 would save £24.27 a month, or £291.20 a year, from their workplace pension. After 46 years, they would have saved £54,800. But under our proposal of abolishing the lower earnings limit, this would almost triple their pension pot to £148,800 on retirement.

4. A person who works two part-time jobs, earning £190 a week in each for £380 a week in total, would not currently have to be enrolled by their employer, so could end up with nothing when they retire. But, if they were enrolled in a workplace pension, they would save £24.27 a month in each job, for a total of £109,700 after 46 years. Abolishing qualifying earnings of £6,240 would generate £297,600 on retirement, nearly tripling their pension savings.

How does this vary across the country?

We don't know exactly how many working people in each constituency are without a workplace pension. But we can make some assumptions based on the income levels and demographics of each place.

For instance, about 10% of workers in Windsor, Streatham, and East Renfrewshire earn less than the auto-enrollment trigger of £10,000 a year. But in Great Grimsby, Scarborough and Whitby, and Great Yarmouth this figure is twice as high at around 20%.

The analysis below estimates the proportion of the workforce that would be automatically enrolled in a pension scheme based on the age structure of the workforce and the mix of full-time, part-time, and public and private sector workers.

There is a clear cluster of seats in London that would see a smaller-than-average increase in workplace pension enrolment. Conversely, there are more seats in West Yorkshire, the Black Country, and the South West where pension enrollment would increase the most.

The constituencies that would see the smallest increase include:

- The Cities of London and Westminster
- Putney
- Ruislip, Northwood and Pinner
- Twickenham
- Sutton and Cheam

This is in addition to some other less-deprived areas outside London like South Cambridgeshire, Tatton, Rushcliffe, and Altrincham and Sale West. But the pattern is not just tracking deprivation. We also see a few constituencies like Hackney South and Shoreditch, Walsall North, and Glasgow North West, which have relatively fewer young and part-time workers.

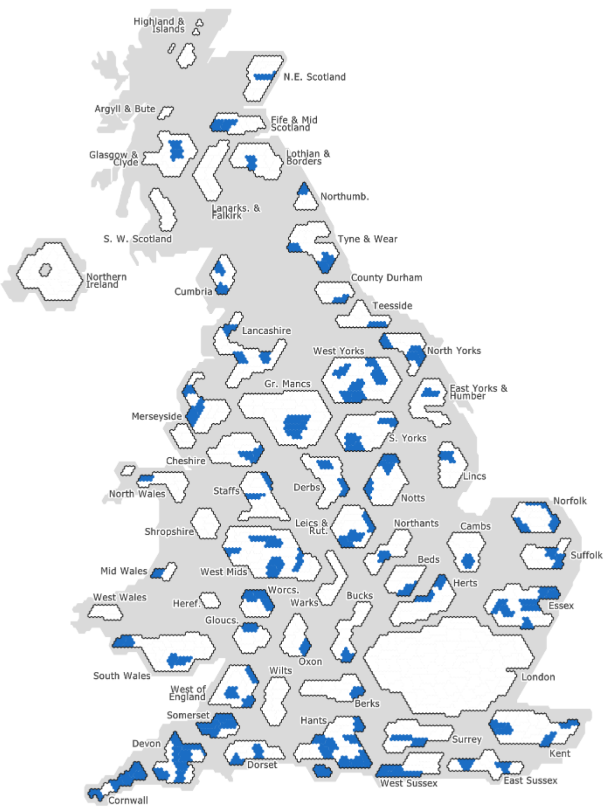
Areas that would see the largest increase in workplace pension enrollment will have higher shares of younger and part-time workers, and many also tend to have lower incomes on average. This list includes the following seats:

- North Cornwall
- Mansfield
- Hyndburn
- Leeds North West
- Cardiff Central
- Workington

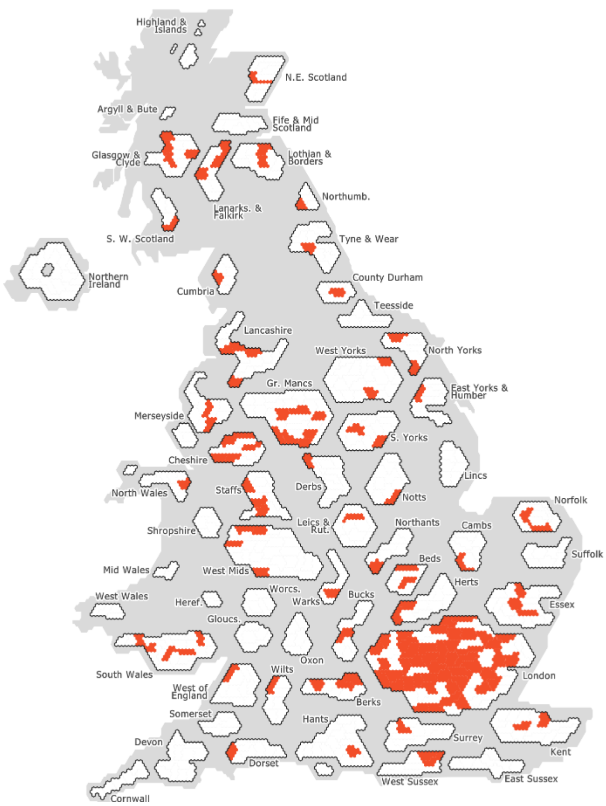
Figure 3: Constituencies with the greatest and smallest projected increase in auto-enrollments

Source: Annual Population Survey

The 20% of constituencies that would see the greatest increase in the proportion of people with a workplace pension



The 20% of constituencies that would see the smallest increase in the proportion of people with a workplace pension



Recommendations

In 2017, the Government's Automatic Enrollment Review recommended "lowering the age threshold for automatic enrolment from 22 to 18" and "removing the lower earnings limit so that contributions are calculated from the first pound earned."[4] The review also stated that the Government's ambition was to implement these changes by the mid-2020s. This timescale is right, but businesses will need a more concrete roadmap in order to properly prepare. We propose the following timeline for implementation:

- **2022**: Freeze the auto-enrollment trigger at £10,000 and the qualifying earnings limit at £6,240 (£120 a week).
- **2023**: Abolish the auto-enrollment earnings trigger and age limit so that every employee over the age of 18 is eligible for automatic enrollment in a workplace pension. But pension contributions are still only paid on earnings above £6,240 (£120 a week).
- **2024**: Lower the qualifying earnings limit from £120 a week to £100.
- **2025**: Lower the qualifying earnings limit to £60 a week.
- **2026**: Remove the qualifying earnings limit completely.

The phased approach does, of course, mean that those who are currently younger than 22, or earn less than the threshold, would not benefit from auto-enrollment for several years. For instance, if the abolition of the Lower Earnings Threshold happens in 4 years' time, a 22-year-old now will be 26 and might see a £75,800 uplift rather than a £94,000 uplift had the change taken place this year. In other words, the delay will cost them £18,200 from their pension pot at age 68.

The roadmap that we propose above strikes the right balance between giving employers advance notice and ample time to plan on the one hand, and minimising the costs of delay for younger and lower-income workers on the other hand.

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[4] Department for Work and Pensions (2017) Automatic Enrollment Review 2017: Maintaining the Momentum

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