The Corona crisis and pensions

Government options to help the recovery

by Frank Eich 8th June 2020

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The Corona crisis is on track to lead to the deepest recession in decades, easily surpassing the fallout from the Great Financial Crisis. The crisis has led to a collapse in economic activity, a surge in universal credit applications and has blown the public finances off course for decades. It has been suggested that in the absence of the government's "furlough" scheme - a government subsidy to business to cover labour costs - millions would have already lost their jobs.

Pensions didn't make it into the headlines during the crisis

One area which has made few headlines is pensions. Outside the pensions industry, pensions didn't seem to attract much attention, probably because those who currently draw a pension are more or less protected from the fallout (by receiving the "triple lock state pension" and/or a defined-benefit pension), while those of working age have more urgent issues to worry about, from home-schooling to potential redundancy.

This leaves those in DC schemes close to retirement. One can only hope that they had invested wisely at their stage in the lifecycle to protect themselves from the fallout of the crisis.

The government wants to unwind its Furlough labour-market scheme...

As we leave the dramatic first phase of the crisis and enter what will probably be a prolonged period of uncertainty, pensions are likely to return to the headlines. The government has announced that its pivotal furlough scheme should remain in place until at least October, with employers expected to start contributing to it from the summer onwards.

Employers will have to pay national insurance (NI) and automatic enrolment (AE) employer pension contributions from August for their furloughed staff (so far covered by the government), and from September an increasing fraction of the 80% of salary offered under the scheme.

...but this will only work if businesses can shoulder wage and non-wage labour costs

To be successful, this “exit strategy” requires that businesses will be in the financial position to fulfil their side of the deal. And this will depend on what type of recovery we will get. If we experience a “v-shaped” recovery as initially hoped for, then this might just work out well for everyone involved. If we experience a weaker or more drawn out recovery though (and this is what many forecasters now believe is most likely), then businesses might not be in the position to do so and will either have to make an increasing number of staff redundant (with staff consequently also losing access to work-based pensions) or will continue to rely on the government, for example in the form of an extended furlough scheme. This would not only leave an ever-increasing hole in the public finances; it would also slow down the necessary adjustments in the labour market to adapt to a post-Corona world.

Temporary NIC holidays could support the recovery...

Still, we shouldn’t be surprised to see the government change its policies again over the coming months, especially if the recovery turns out to be more drawn out than initially hoped for. For example, it could continue to pay NI and AE employer pension contributions (thus squeezing non-wage labour costs) while asking businesses to start contributing to the wage element of the furlough scheme.

Indeed, it might make sense to reduce non-wage labour costs even for workers in active employment, especially in the private sector. Given the precarious state of the economy this might make all the difference between staying in employment and continuing to build up future pension entitlements or being made redundant. Further analysis of the uptake of the scheme so far would have to be carried out to determine the cost effectiveness of such a measure.

We should also expect continued - or even greater - flexibility around DB pension schemes as we come to terms with the new economic realities. Many corporate sponsors just won't have the resources to fill any funding shortfalls any time soon. According to the Pension Protection Fund (PPF), two thirds of UK DB pension schemes covered by the PPF were in deficit – meaning that their liabilities exceeded their assets - in April 2020 compared with just more than half a year ago (though admittedly this share is still lower than a few years ago). Nearly a third of all liabilities were in schemes with funding ratios of less than 80 percent, in other words their assets only covered at most 80 percent of their liabilities.

Last but not least, the government could lower employee NI and take on parts of the AE contributions to increase households’ disposable income and support work-based pensions. To incentivise households to use these additional funds to increase private consumption rather than (net) savings over the coming months, the government could complement this measure by reducing VAT rates on a temporary basis, as last done in 2008 during the Great Financial Crisis.

...but eventually policy makers and society will need to answer the question of who will pay

Protecting the state pension, helping businesses survive and supporting the recovery costs a lot of money. According to the Office for Budget Responsibility’s latest estimates the policy measures announced in response to the Corona crisis alone will cost around £130 billion this fiscal year. Given the circumstances this is money probably well spent. Eventually though policy makers and society more widely will need to face reality and ask themselves who will pay for all this, in particular as pressure on National Health Service and social care funding is likely to intensify in the wake of the Corona crisis.

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